



# IMF POLICY PAPER

## POLICY REFORM PROPOSALS TO PROMOTE THE FUND'S CAPACITY TO SUPPORT COUNTRIES UNDERTAKING DEBT RESTRUCTURING

APRIL 2024

IMF staff regularly produces papers proposing new IMF policies, exploring options for reform, or reviewing existing IMF policies and operations. The following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its April 9, 2024 consideration of the staff report.
- The **Staff Report**, prepared by IMF staff and completed on March 15, 2024 for the Executive Board's consideration on April 9, 2024.

[The documents listed below have been or will be separately released.]

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**International Monetary Fund**  
**Washington, D.C.**



## IMF Executive Board Endorses Reforms to Promote the IMF's Capacity to Support Countries Undertaking Debt Restructurings

FOR IMMEDIATE RELEASE

**Washington, DC – April 9, 2024:** The Executive Board of the International Monetary Fund (IMF) endorsed today the recommendations of the IMF staff paper *“Policy Reform Proposals to Promote the Fund’s Capacity to Support Countries Undertaking Debt Restructurings.”* The reforms are designed to ensure a more agile approach to IMF support to countries undertaking debt restructuring while maintaining adequate safeguards for IMF financing and reinforcing the existing architecture for debt resolution.

A number of recent IMF-supported programs involving debt restructurings experienced significant delays from the time Staff Level Agreement was reached until the time the necessary official creditor assurances were provided to allow the approval of IMF financing.

There has been a marked improvement lately and cases are moving forward more quickly, with substantial progress in collaboration among official bilateral creditors. For example, while it took Chad 11 months to move from a Staff-Level Agreement with the IMF staff to secure the creditor assurances needed for approval of IMF financing; it took Zambia 9 months to reach this milestone, Sri Lanka 6 months, and Ghana 5 months. But more progress is needed.

The staff paper draws lessons from this experience and proposes a set of reforms in five areas, which should ensure a smoother and speedier process in the future:

- (i) clarifying when and how to apply additional safeguards under IMF’s financing into official arrears policy, which should help avoid delays at this stage;
- (ii) strengthening the effectiveness and broadening the applicability of financing assurances reviews when there is an ongoing debt restructuring, to better encourage adequate progress with the restructuring;
- (iii) establishing a more robust and agile approach for deriving financing assurances from official bilateral creditors (based on supporting and observing their processes) with the aim to establish these assurances more rapidly;
- (iv) adjusting the IMF’s Approval-in-Principle procedures so that they can be used to provide a modality for IMF engagement with the member until financing assurances are established for IMF financing; and
- (v) clarifying how the IMF can provide support to members facing arrears to official creditors when they also face an emergency situation, like a natural disaster.

The reforms are designed to support the existing architecture for debt resolution, preserving and complementing what works well while addressing time gaps that can be created by IMF requirements and enhancing information flows. The reforms recognize different official creditor processes and provide a robust framework to support their participation in restructurings on

terms consistent with restoring debt sustainability. The reforms are also consistent with different sequencing of official and private restructurings (although this choice remains with the debtor and creditors). For the IMF, the reforms are overall expected to promote more agile engagement while maintaining adequate safeguards.

### **Executive Board Assessment<sup>1</sup>**

1. Directors welcomed the opportunity to consider reforms to promote the Fund's capacity to support countries undertaking debt restructurings. Directors agreed that, notwithstanding substantial progress in recent cases, the Fund's ability to assist members in resolving their balance of payments problems may still be constrained. Directors, therefore, appreciated the opportunity to consider certain policy reforms to better reflect the current context. Directors agreed that the proposals endorsed today are accurately reflected in the Executive Board understandings in Supplement 3 of SM/24/65 to be issued shortly.

### **Strands 1, 2 and 3 under the LIOA**

2. Directors agreed that the Lending Into Official Arrears (LIOA) policy remains broadly appropriate and that the current guidance on application of the first, second, and third strands of the policy should be retained. Most Directors agreed that Strand 1—creditor coordination through a representative standing forum such as the Paris Club or the Common Framework involving the Paris Club—should remain the central focus of the LIOA policy and should be used whenever it is or becomes available. A few Directors stressed the urgency of recognizing the G20 Common Framework more generally as a representative standing forum. Directors also reiterated that, consistent with its current policy, the Fund would normally not apply Strand 3 (i.e., the three criteria) to a creditor or a group of creditors with an adequately representative share of total financing contributions, in particular assessing whether the Fund support would have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases.

### **Strand 4 under the LIOA**

3. At the same time, Directors agreed on the need to clarify how to apply additional safeguards for Fund lending when the three existing strands cannot provide a pathway forward. In this regard, Directors supported the addition of a fourth strand under which the Fund shall seek additional safeguards where an adequately representative agreement has not been reached through a representative standing forum, consent is not forthcoming within 4 weeks of being requested, and the three criteria under Strand 3 cannot be satisfied with respect to an official bilateral creditor. The approach would distinguish the Fund-supported programs with normal access from those with exceptional access under the GRA or the PRGT or high combined access under the GRA and PRGT.

4. In the first case, Directors agreed that the “standard safeguards approach” would apply (except as noted below). This would require a combination of program design elements—including the phasing of access under the arrangement (with an initial purchase or disbursement capped at low access), program conditionality to support the restructuring

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<sup>1</sup> At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.IMF.org/external/np/sec/misc/qualifiers.htm>.

process where warranted under the Guidelines on Conditionality, and a debtor commitment to good faith efforts to establish safeguards for Fund lending.

5. In the second case, Directors agreed that the “enhanced safeguards approach” would apply, which requires the debtor commitment and conditionality requirements under the standard safeguards approach, and in addition a direct commitment to the Fund by a sufficient set of creditors about their restructuring intentions. Where such a commitment is provided, arrears would be considered eliminated (for purposes of the application of the LIOA policy) for both participating and non-participating creditors. Directors agreed with the definition of a “sufficient set” of creditors and the description of the type of commitment as set out in paragraph 22 of the paper. A “sufficient set” of creditors requires the participation of any standing creditor forum as well as any creditors with significant influence over the debtor. For this purpose, a creditor is considered to have significant influence over the debtor when it has the ability to extract repayment on more favorable terms, inconsistent with program parameters.

6. Directors agreed that the standard safeguards approach will normally be sufficient for normal access cases that fall under Strand 4, but complex cases, involving the prospect of prolonged negotiations or creditor coordination issues would necessitate a shift to the enhanced safeguards approach. Thus, the Strand 4 approach would shift to enhanced safeguards based on an explicit signal that a creditor or creditor group to which the three criteria in Strand 3 cannot be satisfied either: (1) is unwilling to restructure their claims in line with program parameters; or (2) views additional support by the Fund to the debtor’s effort to coordinate with creditors to be essential. Directors emphasized that it would be important for a Staff Report to transparently and factually explain which creditor(s) requested it, and the reason for a shift under normal access to the enhanced safeguards approach and to limit stigma associated with any request for this shift. A few Directors asked for granular information if available about which members in any creditor group made the request.

7. Directors also agreed that to further support debtor and creditor efforts towards comparability of treatment, the Fund would subject any arrears arising out of exercise of a contractual comparability of treatment clause to the Fund’s non-toleration of arrears policy, as set out in paragraph 21 of the paper.

### **Financing Assurances Reviews**

8. Directors also supported strengthening financing assurances reviews under the LIOA and LIA policies while external arrears remain unresolved, and introducing financing assurances reviews both in cases where arrears are deemed away under Strands 1 and 4 under the LIOA policy and in preemptive restructuring cases needed to restore debt sustainability involving official bilateral creditors until the needed restructuring is complete. Financing assurances reviews would continue to provide the Fund with the opportunity to assess continued compliance with the applicable arrears and financing assurances policies, whether the member’s adjustment efforts are undermined by developments in debtor and creditor relations, and whether, in light of progress, the debt situation does not undermine the restoration of the member’s medium-term external viability and its capacity to repay the Fund.

9. Directors agreed that in these cases, requests for new Fund financing should lay out the expected steps and schedule for the restructuring process in an indicative way. Subsequent reviews should detail progress against that schedule taking into account all developments to determine whether the restructuring remains on track to ensure that overall

program objectives are met. Directors called for transparency in any staff assessment on the consistency of debt restructuring plans with program parameters. They further supported the proposal that financing assurances reviews should more explicitly assess whether the Fund still has appropriate safeguards to proceed with the financing in light of progress with the restructuring, or needs to introduce additional safeguards. They stressed that such additional safeguards should be introduced in a manner well-tailored to the situation and reason for any delay with most Directors agreeing that a clear signal about a creditor's unwillingness to restructure would motivate a shift to enhanced safeguards.

10. Directors agreed that in line with the proposal to use financing assurances reviews to more effectively monitor progress in debt restructurings, going forward, the application of Strand 1 to ongoing and future debt restructuring cases after the effective date of these policy changes would also require the completion of a financing assurances review until such arrears are resolved.

### **Credible official creditor process**

11. For restructuring cases where financing assurances need to be obtained from official bilateral creditors—namely, pre-emptive cases and Strand 1 and 4 of the LIOA policy—Directors agreed that such assurances could be obtained through the Fund's assessment that a "credible official creditor process" is underway. Directors stressed the need for clear guidance on the criteria that the assessment could be built on. In this context they noted that each creditor would need to establish a robust track record in delivering timely and successful debt restructurings on which the Fund could base its understanding of the process, key decisionmakers involved, and the expected timeframe for the completion of the debt restructuring, such that an assessment could be made that the key stage had been reached that would provide the Fund with the necessary assurances. They also noted that in the absence of sufficient information or a robust track record to make such an assessment, required financing assurances could continue to be satisfied by specific and credible assurances on debt relief/financing. Directors stressed that it would be important that assessments of COCP be made in a transparent, evenhanded, and fair manner with enough granularity and robust evidence to allow the Board to make this delicate judgment. They agreed that the process of establishing a track record for each of the non-PC creditors' processes could in principle move broadly at the same speed, since any restructuring case typically involves multiple non-PC creditors.

12. Directors endorsed the proposal that, in pre-emptive cases, financing assurances would only be sought from a "sufficient set" of creditors, as set out in paragraph 22 of the paper. Directors agreed that the policy for preemptive restructuring cases for private creditors remains unchanged.

### **Exceptional circumstances under the LIOA**

13. Directors supported the proposed clarification and guidance on the "exceptional circumstances" clause in the LIOA policy. First, Directors agreed that the "exceptional circumstances" clause in the LIOA policy should focus on natural disasters and a subset of other exogenous shocks, such as large or global shocks. Second, in assessing whether Fund support would be expected to advance normalization of relations with official bilateral creditors and the resolution of the arrears, the Fund's assessment would be based on the debtor's commitment to make good faith efforts toward resolving the arrears and to conduct itself in a way to promote and encourage creditor coordination. Third, Directors expected that the "exceptional circumstances" clause would generally not be satisfied for cases with long-

standing arrears. Finally, Directors agreed that no change to the qualification criteria for emergency financing instruments is required. However, they clarified that, where a staff-level agreement has already been reached for an upper-credit-tranche (UCT) program for a member undergoing a debt restructuring but an emergency situation arises that requires the UCT program to be redesigned, redesigning the UCT program may be infeasible in the emergency timeframe. Directors stressed that even in emergency situations, the best course of action in a restructuring remains to work towards a UCT program, and the provision of emergency financing should not undermine any broader effort underway to secure such a program.

### **Approval in Principle**

14. Directors recognized the continued utility of the Approval in Principle (AIP) as an optional procedural device to bridge engagement gaps when agreement on policies has been reached with the member but financing assurances to restore debt sustainability have not been received. They agreed that a few clarifications to the AIP are warranted in such cases. A decision to approve an arrangement in principle shall specify the date by which the approval would lapse, which would normally be no later than 4 months after approval. A new AIP shall only be permitted once and would normally be subject to a limit of an additional 4 months. The Fund would only approve a new AIP if the financing assurances restoring debt sustainability are likely to be delivered and that the member's economic program is being implemented as agreed and remains on track. Once the financing assurances have been obtained, a second decision of the Executive Board is required to make the arrangement effective, which is normally adopted on a Lapse of Time basis. Directors stressed that, in all cases, staff should aim to bring a UCT program forward for Executive Board consideration as fast as possible.

15. Directors agreed that the above policy changes will enter into effect immediately and will apply to all future purchases and disbursements, including under existing arrangements, where the relevant policies apply. They emphasized the need for careful implementation to ensure their effective, transparent and evenhanded application, with a few Directors stressing in particular the need to minimize the risk of increasing the burden on debtor countries. Directors called for effective communication of the policy changes to all stakeholders, including through the planned Guidance, as well as for adequate support through capacity development and close cooperation with other workstreams, including the Common Framework and the Global Sovereign Debt Roundtable. Directors agreed to maintain the review of the LIOA policy, including the present reforms, on an as needed basis.



March 15, 2024

## POLICY REFORM PROPOSALS TO PROMOTE THE FUND'S CAPACITY TO SUPPORT COUNTRIES UNDERTAKING DEBT RESTRUCTURINGS

### EXECUTIVE SUMMARY

A number of sovereign debt restructurings over the past three years faced significant delays but the cases are now moving forward. These delays slowed access of countries to much needed Fund financial support, and alongside creditors' efforts the Fund had to find ways forward. With significant experience now gleaned from recent restructuring cases, it is important to extract the lessons for Fund policies from this episode. Delays in future Fund engagements need to be minimized where this can be done in a manner consistent with restoring the member to medium-term external viability and ensuring adequate safeguards for the Fund. Such delays can contribute to a deepening of debt distress, making adjustment more difficult, exacerbating the debt problem, and creating inefficiency costs for both the debtor and its creditors.

A review of the recent experience suggests that there are important questions about: (i) how the Fund should apply additional safeguards under the Lending into Official Arrears (LIOA) policy; (ii) how to secure greater depth and definition for financing assurances reviews; (iii) the requirements under the Fund's financing assurances policy (which may create frictions and unnecessary steps); (iv) how to bridge engagement gaps with the debtor country authorities; and (v) achieving greater clarity on how to assist members undergoing a lengthy restructuring process and in arrears to official creditors who face exceptional circumstances such as a natural disaster.

This paper proposes a package of reforms to address these issues. These include: (i) formally introducing a fourth strand into the LIOA policy to define how to apply safeguards; (ii) strengthening financing assurances reviews; (iii) establishing a more robust and agile approach for deriving financing assurances; (iv) adjusting the Approval-in-Principle (AIP) framework so that it can be used to bridge a period until adequate safeguards are established for Fund financing, and (v) clarifying the application of the existing exceptional circumstances clause under the LIOA policy.

The proposals are designed to support the existing architecture, ensure that Fund financing engagement in a restructuring context helps the country address its debt problem, and provide stronger incentives for faster creditor participation on terms consistent with Fund program parameters. Staff expect these reforms to promote more agile and effective Fund engagement, with stronger uniformity of treatment, and without reducing safeguards or requiring additional risk tolerance by the Fund.

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## INTRODUCTION

**1. Global and country-specific factors tipped a number of countries into debt distress over the past few years, and after delays the process is now moving forward.** Affected countries included Ethiopia, Ghana, Sri Lanka, Suriname, and Zambia. The official creditor restructuring process (OSI) has faced delays in the new creditor landscape, but cases are now proceeding, and with greater efficiency over time.<sup>1</sup> For example, it took 11 months for Chad to move from a staff level agreement with Fund staff (SLA) to the time when financing assurances were obtained through the Common Framework (CF) process, 9 months for Zambia to cover the same ground, and more recently 6 months for Sri Lanka and 5 months for Ghana. Moreover, restructurings involving bonds have become more protracted when conducted in parallel to such an OSI process with bondholders awaiting clarity on what official creditors will do.<sup>2</sup> Still, it is important to acknowledge the substantial progress in collaboration with non-Paris Club official creditors. That progress took place over a short time span by historical standards (the well-established processes of more traditional creditors took time to develop to its current level of refinement).

**2. The issue of efficiently dealing with countries in debt distress has nonetheless risen in importance making it a priority to learn the lessons from the experience gained.** Debt levels have risen in the wake of the pandemic and other shocks, fiscal pressures have also risen, and global real interest rates have surged.<sup>3</sup> While Fund World Economic Outlook (WEO) forecasts do not anticipate that a wide range of countries will experience a further significant build-up of public debt vulnerabilities (which could lead to a sovereign debt crisis), this is considered an important risk scenario. The overall challenge is how to build on the existing experience and progress to make the process even faster, given the growing debt vulnerabilities and the pressing need for speed when a member needs to restructure its debt. Delays need to be minimized as they can contribute to a deepening of debt distress, making adjustment more difficult, exacerbating the debt problem, and creating inefficiency costs for both the debtor and its creditors.

**3. For a debt restructuring to proceed smoothly, several things must work well in tandem.**

- **Importantly, restructuring processes need to function well.** Individual creditors need to properly assess the scale of the debt problem, take a decision to help resolve it, decide on an approach for coordinating with other creditors, and then participate in any coordination mechanism as required. Creditor coordination is in fact key to solve “free rider problems” and to achieve an outcome that is timely and in the collective interest of creditors. In turn such creditor coordination requires understanding about the “rules of the game” including how the perimeter

<sup>1</sup>See Macroeconomic Developments and Prospects in Low-Income Countries 2022 for a discussion of the evolution of the creditor landscape.

<sup>2</sup>See the discussion of practices in [Review of the Fund’s Sovereign Arrears Policies and Perimeter](#). Recent experience in, e.g., Zambia, points to a more elongated process.

<sup>3</sup>See the Spring 2023 WEO for a more in-depth analysis.

is set for a debt restructuring, and how comparability of treatment can be assessed and enforced.

- **The Fund’s Debt Sustainability Analyses (DSA) toolkit needs to perform its role well.** The Fund’s DSA can play an important role in the restructuring process, when it is seen as an objective and unbiased tool for assessing debt sustainability which in turn helps the authorities and their advisors negotiate with creditors. As such, it needs to determine the envelope of debt relief and/or new financing needed to restore sustainability as accurately as possible, and transparently explain the considerations that informed this determination. In this way its results can be recognized, accepted, and internalized by both creditors and the debtor.
- **Fund policies need to incentivize progress by both debtors and creditors.** The Fund does not involve itself in the details of debt restructurings. However, its policies for helping resolve a debtor’s Balance of Payments (BoP) problems and restore it to medium-term external viability set important incentives for debtors and creditors to resolve unsustainable debt situations. Policies on debt sustainability, financing assurances, lending instruments, and lending into arrears must work well together for this to happen.

**4. There are issues in each of these areas.** As noted above, creditor processes in the new landscape have slowed dramatically, with disagreements about processes, parameters, and comparability of treatment holding up progress. Despite all efforts, debt transparency remains an issue. Questions have been raised about aspects of the Fund’s DSA frameworks, especially the older framework for Low Income Countries (LIC DSF); there has been a universal call for earlier availability of the results and underlying assumptions and analysis, and there have been calls for greater transparency in DSA output. Finally, against this backdrop, the Fund often may be constrained and delayed in its efforts to design a program capable of resolving BoP problems and restoring medium-term external viability. That is, the Fund may be able to negotiate an economic program but unable to secure the safeguards needed (including financing assurances) to proceed with Fund financing support in a timely manner. Engagement with the debtor on policy implementation and structural reforms can then suffer to the detriment of all stakeholders.

**5. Work is underway to address the first two of these problems afflicting the timeliness of debt restructurings, and continued efforts in these areas will be essential:**

- **To help improve restructuring processes, work on debt transparency continues, and the Fund, the World Bank, and the G-20 Presidency have convened the Global Sovereign Debt Roundtable (GSDR).** The Fund recently reviewed progress with efforts to improve debt transparency and evaluated potential next steps.<sup>4</sup> The joint Fund-Bank Multi-Pronged Agenda will continue to support this work. The GSDR is a critical ongoing initiative which aims to foster common understanding of processes, rules and desirable features of restructuring processes. A series of meetings in 2023 and early 2024 have considered key issues like information sharing, the financing contributions of MDBs, cut-off dates, comparability of treatment, domestic debt

<sup>4</sup>See [Making Public Debt Public—Ongoing Initiatives and Reform Options](#).

restructurings, and the use of state-contingent instruments. GSDR co-chairs issued a Progress Report in October 2023 describing progress on the common understandings achieved on these issues. Further meetings have been held to build on the substantial progress already made towards mutual understanding and trust that is essential to facilitate speedier debt restructurings.

- **The Fund’s DSA toolkit is being updated, and guidance has been provided to enhance transparency of information generated.** The new Sovereign Risk and Debt Sustainability Framework (SRDSF) is being implemented (with 98 out of 121 countries being discussed under the new framework as of end-January 2024). As experience is gained with implementation, the guidance for and reported output of the framework will be refined. The regular review of the LIC DSF is commencing. Interim guidance on using the LIC DSF in restructuring situations will be issued to bridge the gap until the full review is completed. Guidance was issued in 2023 on the sharing of information in restructuring contexts, including related to the DSA, which should facilitate early engagement and information sharing with creditors.<sup>5</sup> The Fund will also continue to support country-level DSA analysis through its donor-funded training program, including courses that support jointly creditors and debtors.<sup>6</sup>

**6. This paper covers proposed adjustments and clarifications to Fund policies (i.e., lending into official arrears, financing assurances, and lending policies).** Improvements to creditor processes and Fund DSAs will take time, and even once in place need to be supported by Fund policies. The Fund recently reviewed its policy on lending into arrears to private creditors in 2022 and found that experience suggests that this policy is already well cast. However, Fund policies may be able to better incentivize speedy debt resolution by official bilateral creditors and this could benefit a wide range of the Fund’s membership and improve prospects for the timeliness of the overall debt restructuring process (i.e., covering both private and official claims). This would help ensure that the Fund maintains its ability to provide timely assistance to members facing debt challenges in line with the Fund’s mandate (i.e., that Fund financing is provided to help a member solve its BoP problems and with adequate safeguards to the Fund’s resources). The time is ripe to consider and extract lessons from the various official restructuring cases, given that they are now proceeding.

**7. The changes proposed would make Fund lending more agile without entailing additional risk-taking by the Fund.** They span several Fund policies and involve: (i) introducing a fourth strand into the Fund’s Lending into Official Arrears (LIOA) policy to define how to apply safeguards; (ii) strengthening the effectiveness and broadening the applicability of financing assurances reviews; (iii) establishing a more robust and agile approach for deriving financing assurances; (iv) extending elements of the strand 4 and financing assurances reviews reforms to a pre-default context (to ensure consistency in the application of Fund policy); (v) adjusting the

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<sup>5</sup>[Staff Guidance Note on Information Sharing in the Context of Sovereign Debt Restructurings.](#)

<sup>6</sup>Through the DMFI facility, the Fund provides training on DSA analysis to low-income countries. In partnership with the CICDC, the IMF provides training jointly to low-income countries and Chinese borrower agencies.

Approval-in-Principle (AIP) framework so that it can be used to bridge a period until adequate safeguards are established for Fund financing (when this is expected to be lengthy); and (vi) supporting access to Emergency Financing (EF) by members undergoing debt restructurings when they face exceptional circumstances caused by an exogenous shock that aggravates their debt distress, such as a natural disaster. The changes are designed to support the existing architecture, and include specific elements meant to support debtor-creditor efforts towards comparability of treatment.

**8. This paper is structured as follows.** Section II outlines the challenges faced under the Fund's current policies. Section III lays out the reform proposals and summarizes how as a package they would deliver greater agility while maintaining adequate safeguards, support the existing architecture, and provide for stronger incentives to speed restructuring processes up. Section IV discusses enterprise risks and mitigating factors. Section V outlines issues for discussion.

## CHALLENGES POSED BY THE STATUS QUO

**9. Against a backdrop of slower restructuring processes, the Fund has had to assess in each case whether its policy requirements for financing engagement have been met.**

Alongside the general requirement that the program overall helps the member resolve its BoP problems and restore its medium-term external viability, the requirements under the LIOA policy must also often be met (since debt restructurings often involve arrears to official creditors). The three LIOA strands provide for: reliance on a representative forum, reliance on consent, or application of the three criteria (normally, to a minority of creditors).<sup>7</sup> In practice, when there are several meaningful official creditors involved, there are two basic approaches in restructuring situations, a representative forum or consent (with the three criteria possibly applied, though normally to only a minority of creditors (Box 1).

**10. In recent cases, it has not been possible to quickly establish that the LIOA requirements for Fund financing have been met.** In general, it has been easy to determine when an adequately representative forum would be the modality although it has taken time to secure the assurances necessary to utilize this strand 1 (e.g., the CF applies only to DSSI eligible countries, and can take time to provide the required assurances). Meanwhile, when a representative forum has not been a possible modality, it has taken time to secure consent from key creditors under strand 2. Finally, it has been assessed that strand 3 could not be satisfied in many cases as the relevant creditors held too large a portion of the debt and/or were seen as too important for mobilizing financing going forward.

<sup>7</sup>The three criteria were applied in 7 cases involving four debtors. See [Review of the Fund's Sovereign Arrears Policies and Perimeter](#).

### Box 1. The Three Strands of the LIOA

**The LIOA allows the Fund to provide financing despite arrears on Direct Bilateral Claims if:**

**Strand 1: There is an adequately representative Paris Club agreement.** This is understood as an agreement by bilateral creditors, involving the Paris Club, representing a majority of the total financing required from bilateral creditors over the program period. The Fund always prefers to work with a representative standing forum, which brings large benefits in terms of creditor coordination.

**Strand 2: In the absence of an adequately representative Paris Club agreement, a bilateral creditor has consented to Fund financing, despite the arrears.** Note that consent does not entail any commitment by such creditor to the Fund to undertake steps to resolve the arrears owed to it.

**Strand 3: In the absence of an adequately representative Paris Club agreement and creditor consent, the Fund can proceed with financing where the following three criteria are met:**

- i. Prompt financial support from the Fund is considered essential, and the member is pursuing appropriate policies.
- ii. The debtor is making good faith efforts to reach agreement with the creditor on a contribution consistent with the parameters of the Fund-supported program—i.e., that the absence of an agreement is due to the unwillingness of the creditor to provide such a contribution.
- iii. The decision to provide financing despite the arrears would not have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases. This criterion would normally not be satisfied with respect to a creditor or group of creditors who represent a majority of official bilateral financing required during the program period (a "majority creditor"). This criterion would also take into account the creditors' track record of participation in restructurings involving Fund financing (e.g., the HIPC initiative). In practice, the Fund has also taken account of case-specific factors that mitigate risks for mobilizing financing (e.g., in the 2015 application to Ukraine's arrears to Russia, the conflict between Ukraine (debtor) and Russia (creditor) was seen as creating creditor incentives specific to the case).

**The design of the policy means that in a restructuring context (where multiple creditors are involved) the Fund essentially has two ways forward:** (i) strand 1; or (ii) strand 2 (consent), with the possibility of the co-use of strand 3 (application of the three criteria, although this would normally not involve a majority creditor or group of creditors).

See the [Review of the Fund's Sovereign Arrears Policies and Perimeter for more discussion](#).

## 11. The approaches that have emerged to provide a way forward under the LIOA policy have effectively defined what present policy is (see Figure 1):

- Where a representative creditor committee has been involved (e.g., the CF), the Fund has simply waited for it to deliver the required financing assurances, with the delay creating some pressure to proceed. Experience is speeding processes up and has also identified barriers now being dealt with in other work streams (i.e., the GSDR and DSA workstreams). An underlying issue for the Fund's policy is how to assess when a financing assurance from the CF is in place in recent cases. This has been through an explicit signal at the CF forum level, but this is subject to each creditor's individual process, and friction can arise over whether the meaning is the same in each case. A second issue, given lingering problems at subsequent program reviews, has been a lack of clarity on how to handle slow progress with the implementation of the different stages of the

debt restructuring itself in the context of the financing assurances review.<sup>8</sup> For instance, at times, it has been challenging to secure the timely signing of an MOU.

- When a representative creditor committee has proven out of reach—an increasing issue in the new official creditor landscape, the Fund has had to work separately with the different creditor/creditor groups involved to secure their consent:
  - Notably, Fund staff has chosen not to apply the three criteria to some hesitant creditors. The creditors who have been slow to agree have varied by case but have all been either majority creditors or creditors with importance for future financing, and thus a difficult fit for existing policy guidance. With non-PC creditors in particular, the Fund has taken the view that they need to be a part of the solution and carefully consulted. At the same time, concerns about creditor coordination and burden sharing that have stalled progress in these cases have pointed to an unresolved safeguards issue for the Fund—proceeding with a combination of consent and application of the three criteria does not necessarily assure that the restructuring will move forward to resolve arrears and restore debt sustainability (see Box 2).

### Box 2. Assurances Under LIOA Strands 2 and 3

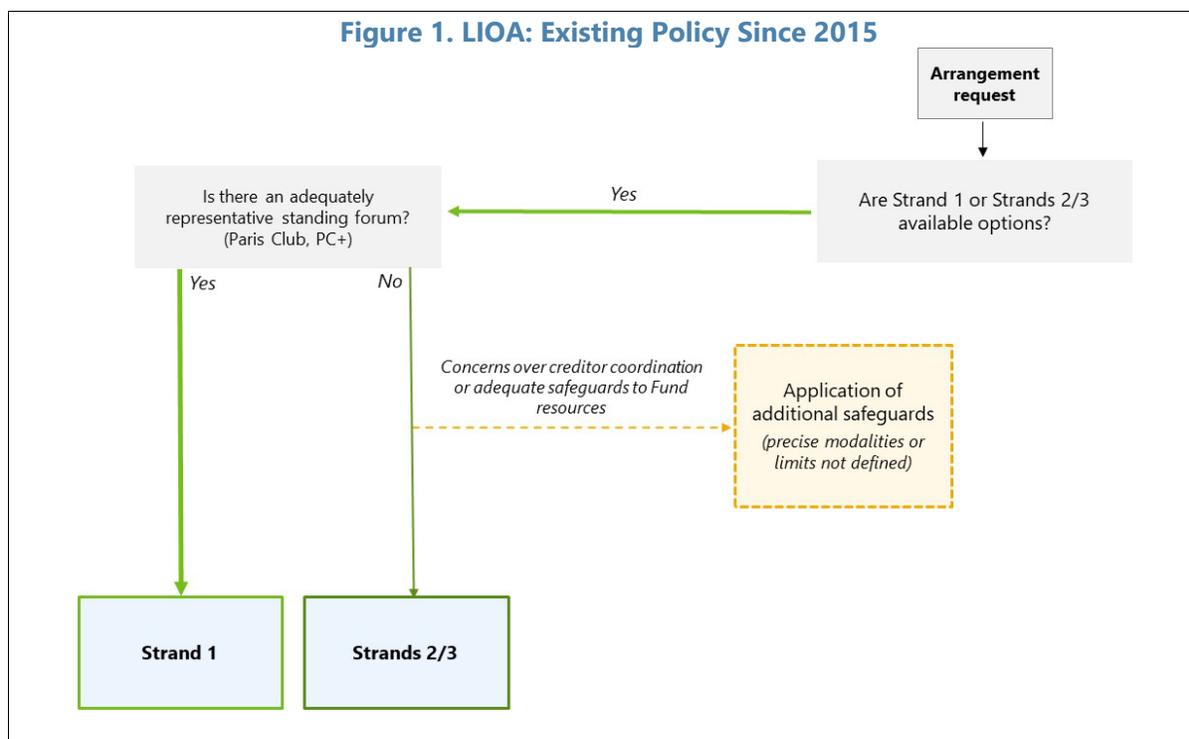
**The Fund staff has determined that the three criteria cannot be met with respect to some creditors in drawn-out restructuring processes.** Application of the third strand to significant creditors would raise critical concerns:

- **Application of the third strand to creditor(s) with influence over the debtor** would not prevent such creditor(s) from trying to extract repayment on more favorable terms inconsistent with program parameters (especially after the end of the arrangement, when the Fund would not be in a position to address debt sustainability concerns, barring a new Fund arrangement).<sup>1</sup>
- **Lack of agreement with any such creditors may also impede progress with restructuring of other official and private creditors.** These other creditors would have an incentive to wait out the eventual restructuring of the claims of the creditor(s) with influence (since these would have first order implications for the sustainability of all restructured claims). In theory they could incorporate comparability of treatment provisions in their contracts, but these are exceptionally difficult to specify in a robust way (as creditors with influence typically have other BoP avenues through which to be compensated).
- **Delayed arrears resolution could undermine economic recovery as uncertainty lingers, as well as delay a return of a debtor to capital markets.** The latter is key to a debtor regaining medium-term external viability and thus also for its ability to repay the Fund, and such an overall approach would thus undermine adequate safeguards for Fund lending.

<sup>1</sup>This concern would not apply to individual creditors operating within a creditor coordination mechanism, where they are constrained by solidarity principles not to seek more favorable terms than others.

<sup>8</sup>The current OSI debt restructuring process involving Fund financing involves three creditor process stages: first, the provision of financing assurances, second, the Agreed Minute/Agreement in Principle/Memoranda of Understanding and third, the actual delivery of legally binding bilateral restructuring agreements. This process would normally take about 12 months. In any event, official bilateral creditors may immediately provide step 3 if warranted.

- In some instances, the approach has been to secure the necessary consent by establishing that the Fund has safeguards because: (i) the debtor is committed to CoT, and (ii) no one creditor has enough influence to undermine expected burden sharing. This has allowed arrangement approval, and some progress towards restructuring and resolution, but with insufficient incentive to move the process along quickly. Creditors have moved at different speeds and creditor coordination problems have continued to hang over the situation. The issue has been revisited later on during financing assurances reviews, but with a need to improvise to establish that safeguards remain in place notwithstanding slow progress (e.g., Suriname 2021-23).
- In other instances, the approach has been to secure consent by establishing additional safeguards including waiting for official bilateral creditors to signal their willingness to restructure in line with program objectives and assumptions underpinning sustainability on a forward-looking basis (“program parameters”). While this parallel approach across creditors de facto secures cooperation, it has proven time consuming with substantial friction over the form and meaning of the financing assurances provided (and whether creditors are de facto providing the same quality of assurance). The delays have created pressures for creditors to proceed. However, the time required has effectively left the Fund without a framework for financing engagement with the debtor country, undermining the ability of the member to take policy actions to resolve its BoP problems, and delaying its efforts to restore debt sustainability and resolve the debt distress. The recent case of Sri Lanka provides an example of this approach.



**12. While the Fund and creditors have been finding a way through, the experience raises a host of issues for Fund policies:**

- i. The application of additional safeguards under the LIOA policy. Should the Fund be more aggressive in applying the three criteria? Concerning additional safeguards, existing Fund policy allows for them,<sup>9</sup> but the question remains as to when and how they should be applied more generally. Should the Fund leave such choices discretionary (noting that interdependencies in creditor decision making may leave the outcome subject to creditor wishes in individual cases) (Figure 1)?
- ii. Better handling situations where, once within a Fund supported program, progress towards a restructuring is slow. Can the currently required financing assurances reviews be given more depth (i.e., by better defining the approaches to assessing and upgrading safeguards) to help make these reviews more effective?
- iii. The application of the financing assurances policy in a consistent and even-handed manner. The FA policy is optimized to the previous official bilateral creditor landscape and does not translate fully to the new creditor landscape. This in turn can create frictions when non-PC creditors are involved. How can the requirements be adjusted to preserve the important safeguard role that the FA policy plays while improving even-handedness and reducing frictions?
- iv. Handling financing assurances related issues in a pre-default context (which includes instances where default is avoided due to a standstill). The Fund may only lend under adequate safeguards, which includes an assessment that the member will be in a position to repay the Fund when its repayment obligations fall due.<sup>10</sup> In a pre-default context, these safeguards are provided by establishing financing assurances, and the standard approach is to seek “specific and credible assurances” on debt relief/financing from each such creditor. Sometimes this can proceed smoothly and quickly (e.g., Ukraine 2023, which featured a standstill). However, this process is in theory vulnerable to the same problems that have subverted efficient application of financing assurances reviews and the financing assurances policy. Moreover, to the extent that a standstill is involved, and no arrears arise, there may be no near-term outlet into the LIOA framework where approaches are better defined.

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<sup>9</sup>See the discussion above in paragraph 11, bullet 2. See also pages 36, 56, and 63 of the recent 2022 review of the LIOA.

<sup>10</sup>Pursuant to Articles I(v) and V, Section 3(a) and paragraphs 5 and 6 of the Guidelines on Conditionality, Decision No. 12864-(02/102), as amended, the Fund may only provide financing that will assist members in solving their BOP problems in a manner consistent with the provisions of the Fund’s Articles and that will establish adequate safeguards for the temporary use of the general resources of the Fund. In other words, first, with respect to UCT financing, Fund-supported programs must be designed with the goal to solve the member’s BOP problem and achieve medium-term external viability and second, the Fund may only lend under adequate safeguards, which includes, at base, a judgment that the member will be in a position to repay the Fund.

- v. Securing engagement with the debtor country through periods of elongated creditor processes. The latter will remain a feature of the landscape for some time (given the issues identified in paragraph 3 above). Can Approval-in-Principal procedures (AIP), which were originally designed to accommodate timing needs related to creditor processes, be adjusted and modified to support better engagement in such circumstances?
- vi. Handling exceptional circumstances such as natural disasters that arise during elongated creditor processes (and when UCT programs are thus not within near-term reach). The prospect of continued delays in providing Fund financing to support UCT programs also raises the question of the standards for applying the LIOA policy to emergency financing in exceptional circumstances.

## PROPOSALS

**13. Staff proposes a package of reforms to address these issues and improve the ability of the Fund to provide financing in debt restructuring cases with adequate safeguards.** The proposals build on existing practices and policies, preserving and complementing what works well, adding functionality to respond to the present circumstances, and filling gaps that would otherwise give rise to problems with even handed application of policies. They aim to incentivize faster creditor processes and be robust to any potential developments (so that policy does not need to be constantly fine-tuned). The proposals respond to each of the 6 areas laid out above. Together they would give the Fund options to proceed faster and with safeguards preserved in instances where actions are now delayed, blocked, or subject to frictions.

### A. Proposed Reforms to the LIOA Policy

**14. More explicit guidance on the application of the LIOA policy is essential for the Fund to provide financial support to member countries.** The policy already allows for additional safeguards. Being more explicit about when such safeguards are warranted would be important for treating creditors in the same way, for providing greater certainty to both creditors and debtors about the process and judgments that the Fund will need to make (allowing these to be internalized in their decision-making and overcoming creditor inter-dependencies), and thus ultimately for speeding up restructuring processes and arrears resolution. Introducing further transparency is also critical to help the Fund explain to the broader public why it is taking certain approaches.

### The 2015 Pathways Under LIOA

**15. The use of strand 1—where the Fund works with a representative forum—should remain the Fund’s central focus.** A representative forum is more efficient at coordinating creditors and can support a restructuring in ways that the Fund cannot, including by shepherding actual negotiations and ensuring CoT among official bilateral creditors. While cases under the CF have involved significant delays, there has been a trend improvement in time required, and staff is confident that this can be sustained. Thus, staff does not propose any change to strand 1.

**16. The Fund must remain willing to utilize consent and/or application of the three criteria to some creditors without seeking additional safeguards.**

- Consent. Where creditors work well together and first mover problems do not exist, consent is the fastest route forward and will provide adequate safeguards. In particular, ensuring that a majority of creditors consent to Fund financing despite arrears strengthens the pressure on the debtor to work in line with program parameters and ultimately can help secure compliance with CoT provisions. In turn, this justifies that safeguards are in place for Fund lending.
- Application of the three criteria. It remains important for the Fund not to allow a holdout creditor to subvert the will of the international community to assist a Fund member. At the same time, preserving prospects for cooperation on future financing is critical for the Fund to discharge its mandate to help its members restore medium-term external viability and solve balance of payments challenges. The staff in particular value the carefully built and maintained relationships with the Paris Club and major non-PC creditors. Still, it could be possible to apply the three criteria to a creditor who could have an important role for future financing. For example, it is possible in the future that such a creditor could shift to a non-cooperative stance with the Fund, signaling no chance for cooperation on future financing regardless of how the Fund proceeds. Staff does not presently see any creditors that raise such a risk, but this will be kept under review. Also, there may be cases in future that involve specific considerations that mitigate future financing or even majority concerns. These would perhaps involve unique non-economic disputes between the relevant debtor and creditor. In all cases, the Board would need to have the final call, advised by staff.

**Utilizing Additional Safeguards—Proposed LIOA Strand 4**

**17. As noted above, the Fund has been using additional safeguards when the LIOA pathways alone cannot provide a way forward, and this requirement needs better definition.**

There are three issues to deal with. First, how to determine that the existing LIOA pathways alone cannot provide a way forward (and that there is thus a need to secure additional safeguards). Second, what these additional safeguards could be. Third, how to apply them in a straightforward and even-handed way linked to the circumstance.

**18. The threshold issue is how to determine that the existing pathways under LIOA cannot provide a way forward.**

- A first case to consider is whether the requirements under strand 1, or a combination of strands 2 and 3, can be met. It is generally straightforward to make such a determination, starting always with the Fund's preferred route, working with a representative standing forum (see Box 3).
- A second case may arise where it is possible to apply the second and/or third strands, but the Fund requires additional safeguards. This would include situations where exceptional access is proposed (and thus a high probability of debt sustainability must be assessed, per the second

exceptional access criterion).<sup>11</sup> It would also include situations under normal access where: (i) a creditor's authorities have conveyed that though they consent, they have no intention of restructuring in line with program parameters; and (ii) creditors communicate to Fund staff a desire for strong support to creditor coordination. Leaving such situations unaddressed would portend future program problems which accordingly should be addressed upfront.

### Box 3. Determining Whether the Existing LIOA Strands Can Provide a Path Forward

**Strand 1 (adequately representative agreement via a “representative standing forum”).** The Fund always prefers to work with a representative standing forum, given the benefits that this brings to a restructuring process from start to finish, including in actual negotiations (in which the Fund cannot be involved). The G-20 leaders have been clear about the applicability of the CF (and thus to which countries it can be assumed to apply), and outside of this the Fund maintains close communications with the PC and is thus aware of the role that the PC is expected to play in a restructuring, and those creditors who would participate through it. The Fund also has a methodology for determining whether a standing forum is representative for LIOA policy purposes.<sup>1</sup> The Fund is thus in a position to make such a determination which is the first step in assessing whether the LIOA requirements are met.

**Strand 2 (consent).** If strand 1 does not apply, then staff seeks consent from creditors. Note that creditors could withhold consent when multiple significant creditors are involved due to “first mover” problems. They could also fail to provide consent on a timely basis due to elongated internal processes, or because they do not see a need for a restructuring on a scale consistent with program parameters. In practice, it may be difficult to determine the precise reason, but non-consent or a non-answer can be observed.

**Strand 3 (application of the “three criteria”).** Where strands 1 and 2 cannot be applied, staff would assess whether strand 3 could be applied. The third criterion of strand 3 presents the crux of the assessment for whether this strand could be satisfied. The Board’s guidance is that this criterion normally would not be satisfied for a creditor or a group of creditors that is providing a majority of total financing contributions from official bilateral creditors over the program period. This is straightforward to assess, including through existing guidance (see Box 1), though there is also a margin in practice to consider case-specific factors regarding creditor-debtor relations that might mitigate other considerations (e.g., Ukraine 2015).

<sup>1</sup>See [Reforming the Fund’s Policy on Non-Tolerance of Arrears to Official Creditors](#). Note that while the Fund calculated representativeness, the Fund defers to the PC in its determination of the group of creditors constituting a PC+ agreement.

Note: See Appendix 5, Table 1 for cases in which existing LIOA strands have been applied.

**19. There are three types of safeguards that can be applied, when needed.** These are: (i) program design elements (i.e., phasing and conditionality); (ii) commitments from the debtor to creditors on good faith efforts (which embeds an intention to deliver comparability of treatment); and (iii) direct commitments from a “sufficient set” of creditors to the Fund about their restructuring intentions. These safeguards can together help assure that a sufficient stock of the arrears will be resolved, that other official bilateral creditors will be brought in to resolve arrears on similar terms, and that the restructuring will be agreed in a timely manner by a sufficient set of creditors within the

<sup>11</sup>See Decision No. 14064-(08/18), February 22, 2008, Access Policy and Limits in the Credit Tranches and Under the Extended Fund Facility and on Overall Access to the Fund’s General Resources, and Exceptional Access Policy, as amended.

program period.<sup>12</sup> Conversely, without program design to better pin down a timeline, a restructuring would likely become elongated, with the negative impacts seen in present cases, and safeguard issues for the Fund. Without the right approach by the debtor, creditors would likely wait each other out and resist proceeding with a debt restructuring. And without a sufficient set of bilateral official creditors committed, other creditors would be more likely to hold out.

**20. To operationalize a straightforward approach to additional safeguards linked to (evolving) circumstances, staff proposes the following (Figure 2):**

- To seek additional safeguards in two cases. First, when strand 1 (and 3) are not available, and consent is not forthcoming by 4 weeks after a staff request for such (though staff may choose to wait longer if deemed useful). Based on consultations with creditors, staff believes that allowing 4 weeks would appropriately balance the need to move forward with the Fund-supported program, and the need to give creditors time to assess their desired modalities for cooperating with each other and with the Fund. Second, when the program would involve exceptional access, staff would need to explain to the Board the basis for a determination that additional safeguards would be needed.
- To set a standard approach for normal access cases (i.e., the “standard safeguards approach”). This would be based on a combination of program design elements and debtor commitments to creditors to establish safeguards for Fund lending. Essentially this would involve an arrangement with capped initial access, with program conditionality to support the restructuring process (where warranted under the GoC), and a commitment from the debtor to good faith efforts. Box 4 discusses this in more detail. This approach would be expected to catalyze progress from creditors concerned about coordination (i.e., because they are reassured by the debtor’s commitments and/or by the clarification of the timeline and steps in the restructuring provided by program design elements). This builds on what was done at program inception for Suriname.
- To set a standard approach for exceptional access cases (i.e., the “enhanced safeguards approach”).<sup>13</sup> This would involve the “standard safeguards approach” described above, and in addition, a direct commitment to the Fund by a “sufficient set” of creditors about their restructuring intentions (i.e., a “financing assurance”, as discussed in the next section). Note that if a sufficient set commits, then creditor coordination has de facto been achieved. Other creditors’ arrears would be deemed away for the purposes of Fund arrears policy.<sup>14</sup>

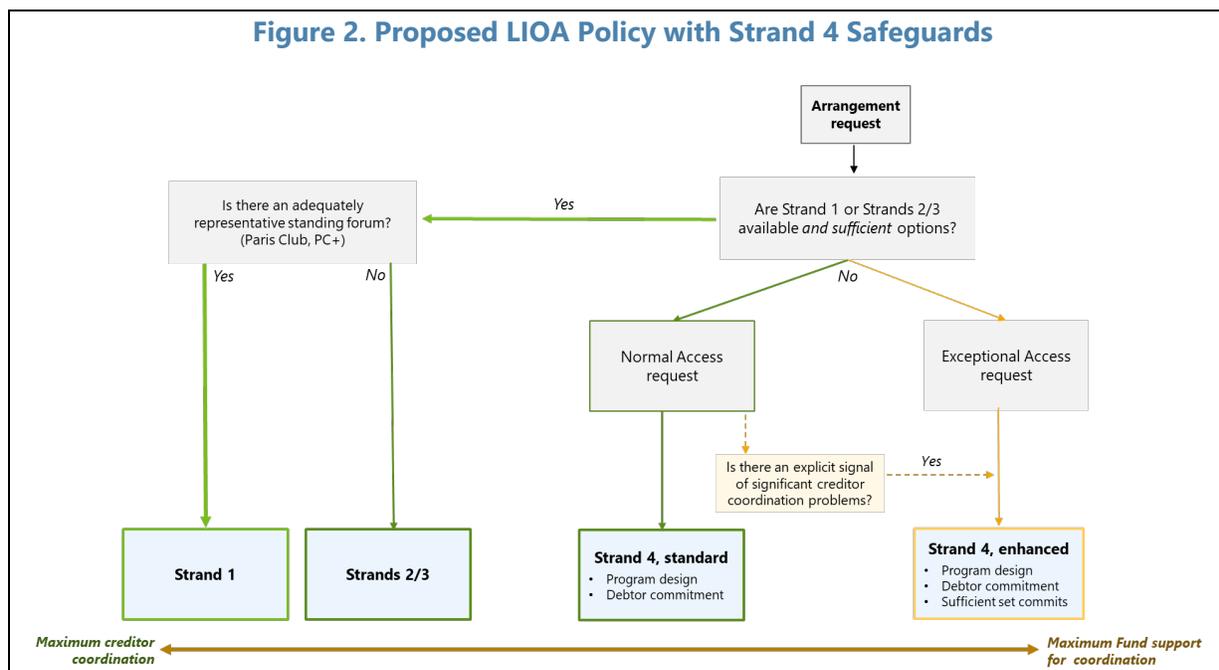
<sup>12</sup>On occasion completing a restructuring agreement can extend beyond the program period, but the involvement of a representative forum generally assures efficiency in such a process.

<sup>13</sup>Such cases would include those involving access above the normal limits under the GRA, the PRGT, or high combined access under the GRA and PRGT (PS-HCC).

<sup>14</sup>Note that in practice, unresolved arrears to non-participating creditors that are deemed away on the basis of an adequately representative Paris Club or Paris Club Plus agreement have not typically posed any obstacle to the Fund’s provision of financing to help the member restore medium-term external viability (even in the rare instances when such arrears persist for decades, as in the case of some legacy HIPC-era arrears).

This is similar to the approach taken at arrangement approval in the case of Sri Lanka.

- To expect the standard safeguards approach to be used in regular access cases but allow a shift to the enhanced safeguards approach informed by explicit signals from significant creditors. The latter would be defined as a creditor or creditor group regarding whom the three criteria could not be satisfied. Staff would need an explicit signal from such a creditor (or creditor group) that it was unwilling to restructure in line with program parameters, or that it saw an essential need for the Fund to support greater creditor coordination. As noted, where such a creditor or creditor group makes such signals, problems lie ahead, and it is best to resolve them upfront to derive the safeguards required for Fund lending so as to help the member address BoP problems and restore medium term external viability. The Staff Report would explain why the enhanced approach was invoked, which creditor(s) requested it, why the use of direct creditor coordination mechanisms was not feasible in the situation, and any efforts made by creditors to directly coordinate.
- To immediately shift to strand 1 if it becomes available. It is possible that in some circumstances, efforts to achieve the enhanced safeguards approach could lead creditors to decide to coordinate more formally through a recognized forum. In such a situation, the Fund’s approach would revert to LIOA strand 1 (with any realized safeguards preserved).



#### Box 4. Application of Proposed LIOA Strand 4 Standard Safeguards

In terms of standard safeguards, program design would be one key focus:

- **First, structural conditionality could be used to incentivize timely actions by the debtor to keep a restructuring process on track.**<sup>1</sup> There can be elements of the restructuring process that are within the control of the debtor authorities (e.g., specific actions in terms of debt transparency, sharing other information, or other milestones in the process like sharing an offer) where actions to deliver them would meet the standards set forth in the Guidelines on Conditionality.<sup>2</sup>
- **Second, quantitative conditionality could be used to help address concerns that some creditors may attempt to extract payments not in line with program parameters.** This is a concern for the Fund, since this may undermine prospects for overall creditor cooperation and since in any event safeguards on Capacity to Repay (CtR) in an unsustainable debt situation can imply very limited or no room for near-term debt service payments under program NIR and fiscal targets. For legal reasons, the Fund cannot go beyond this to insist on a standstill, but in some situations the debtor may have already decided to default on most or all of its creditors and arrears may have arisen, giving further credibility to such conditionality.<sup>3</sup> It would be important for staff to set QPCs comprehensively, with full coverage of public sector accounts from below the line. This would require consultation with the debtor's financial advisors to understand the full structure of debt and debt service.
- **Third, given residual safeguards risks to the Fund**—that the restructuring may still leave the Fund exposed—use of normal access safeguards to proceed would be on the basis of a capped upfront disbursement of Fund resources, i.e., up to but not exceeding the annual access limits under the Fund's emergency financing instruments (the "regular window" under the RCF/RFI). Of course, phasing should align with a member's BoP needs and policies, and thus the pace of implementation of adjustment measures would also have to be altered (to eliminate financing gaps).

**A key second element of safeguards in the first type of case would be a commitment by the debtor to the creditors concerning good faith efforts.**<sup>4</sup> Creditors will generally be willing to move forward, notwithstanding the lack of a coordination mechanism, if they are confident that they will receive the necessary cooperation from the debtor and that being a "first mover" will not disadvantage them relative to other creditors.<sup>5</sup> Thus, an upfront public commitment of the debtor authorities to good faith efforts could generally provide a way forward (e.g., Sri Lanka and Suriname). Good faith efforts would be understood per the existing LIOA definition as encompassing promises concerning: process elements (i.e., approaching the creditors, offering to engage in substantive dialogue, seeking a collaborative process, and providing relevant information on a timely basis); and the terms offered (i.e., consistent with the parameters of the Fund-supported program, and not implying a contribution disproportionate versus other bilateral creditors). The commitment to a proportionate contribution across creditors would establish an intention to deliver comparability of treatment. The debtor may also choose to make commitments to private creditors in this context (LIA definition) to facilitate broader creditor cooperation and options over sequencing.

<sup>1</sup>See Appendix II for examples from previous programs. While conditionality has previously been set on PSI processes, this can be generalized in many cases to the OSI setting.

<sup>2</sup>Operational Guidelines on Relationship between Performance Criteria and Phasing of Purchases under Fund Arrangements, Decision No. 7925-(85/38), March 8, 1985, as amended.

<sup>3</sup>In the event that a standstill is legally in place, the Fund's pre-default policy applies. This is discussed below.

<sup>4</sup>Creditors will typically identify a methodology for assessing CoT amongst themselves, and the Fund does not attempt to prescribe this. There are different methodologies and views about how this should be done.

<sup>5</sup>Creditors could in fact deliver this assurance themselves via contractual provisions allowing creditors to claw back their treatment if CoT is not observed. In the official bilateral creditor sphere, PC agreements can include a claw back clause to enforce CoT, with discretion as to how it is ultimately applied. A Most Favored Creditor Clause (MFCC) has been proposed for use by some practitioners and creditors (including commercial ones) and have been only used in a few instances involving commercial creditors. See Buchheit, Lee C. and Gulati, Mitu, Enforcing Comparable Treatment in Sovereign Debt Workouts (September 26, 2022). Virginia Public Law and Legal Theory Research Paper No. 2022-67, Virginia Law and Economics Research Paper No. 2022-23, Available at SSRN: <https://ssrn.com/abstract=4229061> or <http://dx.doi.org/10.2139/ssrn.4229061>. But in practice, such clauses are difficult to enforce (particularly since CoT must be assessed over several dimensions). In any event, contracts by nature arise after the inception of the Fund supported program and at the end of the restructuring process, so this would in most cases not prove effective at resolving a first-mover problem that holds up a program.

#### 21. A key underpinning to this approach concerns the debtor's commitment to good faith efforts including CoT, and it is important to consider how the Fund can support this

**consistent with its policies.** Note that CoT considerations are currently given weight under Fund policies, and staff proposes to further strengthen the incentive Fund policies provide. There are three distinct time periods to consider:

- The period between when there is an agreement-in-principle on the restructuring and the conclusion of the debt restructuring agreement. If during this period creditors raised concerns about CoT, this would almost certainly prevent a conclusion of the agreement. Creditors would indeed likely want to revisit the agreement-in-principle to better secure CoT. Any pending financing assurances review under the Fund supported program would then have to take into account this important development in debt-creditor relations. The program would likely not be able to move forward until this could be resolved. In this way Fund policy can already give weight to CoT considerations.
- The period between the completion of the debt restructuring agreement (when arrears are resolved) and the end of the program. If a restructuring agreement was in place and arrears resolved, financing assurances reviews would no longer apply. However, a decision by creditors to trigger CoT claw backs would create financing and possibly sustainability gaps in the program, which would need to be closed for any program review to proceed. In this way, Fund policy again already gives weight to CoT considerations.
- The post-program period. Once a program is concluded the Fund does not presently have a mechanism to support continued CoT. The Fund could, however, create a deterrent. This could be done by modifying the arrears policy to re-classify any new arrears that arise due to the exercise of a CoT clause. These arrears would in this proposal be seen, in the context of a new arrangement, as “not OSI-related” for arrears policy purposes, even if further OSI would be required. This treatment would subject such arrears to the Fund’s non-toleration of arrears policy (as opposed to OSI-related arrears which fall under the LIOA policy). While this would not rule out the restructuring of such arrears, it would require the non-objection or acquiescence of that creditor to the Fund approving any new financing and/or completing any subsequent reviews, providing the aggrieved creditor extra leverage. This proposal would thus be a deterrent by raising the ex-post cost for all involved (but its effectiveness does rely on the debtor authorities recognizing and internalizing this).<sup>15</sup>

**22. A second key underpinning concerns how to define a “sufficient” set of creditors from whom to seek a commitment under the enhanced safeguards approach.** The issue of how to make an assessment about commitments of individual creditors in the “sufficient set” is left to section C. A simple definition of the sufficient set—analogueous to the approach under LIOA strand

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<sup>15</sup>To the extent a contractual dispute arose about the amount or validity of claims arising from the applicability of the CoT clause, the Fund’s current doctrine on disputed claims would apply. Under this practice, where the Fund accepts a member’s representation that the validity or amount of a debt claim is in dispute, such disputed claim does not give rise to arrears for Fund purposes. However, such claims are taken into account (as a contingent claim) for purposes of determining whether adequate assurances exist for the financing of a Fund-supported program and the Fund DSA. See Sovereign Debt Restructuring—Recent Developments and Implications for the Fund’s Legal and Policy Framework, April 2013, Annex I, at FN. 11.

1—would be to look for an “adequately representative” set; that is, a creditor or a group of creditors that accounts for a majority of the total financing contributions required from official bilateral creditors over the program period (covering both the restructuring and new financing). A more appropriate definition (in view of the aim to more clearly establish Fund safeguards and/or resolve a deeper creditor problem through collaboration with creditors) would require involvement of any representative forum (whose members are creditors), and any creditors with influence over the debtor. Such creditors also need to be “at the table” with a voice. In this context:

- A creditor could be considered as having potential influence over the debtor if it has the ability to extract repayment on more favorable terms inconsistent with program parameters. Indicators of this include enforceable and economically meaningful collateral or collateral-like features in its debt contract; a share in the total debt stock or debt service flows that is high (e.g., among the top three creditors); or if its total BoP relationship with a country (trade and capital flows) is high (e.g., in the top three countries over the previous 5 years).<sup>16</sup>
- However, case-specific mitigating factors would also need to be assessed by staff, for instance the inherent flexibility in the debtor countries’ trade (e.g., because the country has alternative sources of supply in theory); or whether the collateral is playing a positive role (i.e., “related” collateral which would directly give rise to repayment capacity).<sup>17</sup>

**23. Staff proposes embedding the standard and enhanced safeguard approaches in the LIOA policy under a new fourth strand.** This strand would be applied when the existing three strands cannot alone provide a way forward; or when the Fund determines that additional safeguards are needed (per the considerations in paragraph 20, bullet 1). Under this new strand, the Fund would consider lending into official arrears only if the safeguard requirements described in paragraph 20 are met, according to the type of case. The assessment required in any one case would be a judgement by the Board, informed by advice and assessment from staff (based on the factors listed above).

## B. Proposed Reforms to Financing Assurances Reviews

**24. The Fund presently has a procedural tool under the LIA and LIOA policy, the financing assurances review, but the lack of a systematic approach limits its effectiveness in practice.** Under the policy, the financing assurances review is required to take place alongside normal program reviews so long as there are unresolved arrears. It is supposed to assess whether adequate safeguards remain in place for the further use of the Fund’s resources and that the debtor’s adjustment efforts have not been undermined by developments in debtor-creditor relations. While originally envisaged as a substantive safeguard, financing assurances reviews are often not reported in any meaningful depth at present. And while in many cases there are substantive discussions

<sup>16</sup>Appendix 1 shows the share of the largest bilateral creditor and the largest trade partner for LICs and MACs. It is common for countries to have very high concentration along one of these dimensions, though cases where both trade and bilateral credit are concentrated are relatively rare.

<sup>17</sup>An example of related collateral is aircraft, under an aircraft leasing arrangement.

among departments about whether assurances have been obtained, the extent of engagement with the authorities, creditors, and their advisors may not always be as structured and deep as desirable and often the Board may not have deep enough insight into this engagement and the overall process.

**25. Staff proposes to make Fund financing assurances reviews more effective, consistent with the original intent of the LIA policy and the Guidelines on Conditionality (GoC).** This would involve further guidance on both the arrangement approval and review stages (for programs where a financing assurances review under either the LIA and/or the LIOA policy is required):

- The Staff Report for the arrangement request would be expected to present a clear depiction of the expected steps and the schedule for a restructuring process. This would be based on an understanding of the schedule developed with the debtor and its advisors, and would cover key steps (e.g., information sharing, offers, etc.). The timeline would be understood to be indicative, and the Staff Report would need to be clear that the timeline would be subject to change in the event of material developments. Consistent with current Fund policy, there should be clarity about the creditors involved, and the process being utilized (e.g., common framework, PC and others in parallel, etc.).
- The subsequent financing assurances review would then be expected to draw on the indicative steps and schedule to give a clear assessment of the progress with the debt restructuring and whether it remains on track to ensure that overall program objectives are met (i.e., restoring debt sustainability and medium-term external viability).
- At the financing assurances review stage, a determination would also have to be made about whether the Fund still has appropriate safeguards to proceed with the financing. Where the restructuring is on track or even ahead of the indicative schedule, that conclusion would be normally within reach without further actions. However, lack of progress could raise concerns. The LIOA policy would need to be satisfied in any event, and the strand that applies could differ from the one originally applied, especially in the absence of progress. Thus, if strand 1 had been pursued at arrangement approval, it would be possible to apply (further) safeguards related to program design, if lack of progress raised concerns; and if strand 2 and/or strand 3 were utilized at arrangement approval, it would be possible to move to either the standard or enhanced safeguards approach under strand 4 if lack of progress raised concerns. If additional safeguards had already been applied at the arrangement approval stage, then it would be possible to further strengthen the safeguards utilized under the standard case or even apply the enhanced safeguards approach. Finally, in the same situation, where the exceptional access safeguards approach had been applied at arrangement approval, it could be possible to consider additional safeguards covering phasing and conditionality, but it would usually be appropriate to require agreement in principle on the official sector restructuring as a condition for completing the financing assurances review.

- Consistent with current requirements, inability to complete a financing assurances review would require holding the program pending progress in line with the initial indicative timeline or possibly with the application of additional safeguards.
- In completing a financing assurances review, where the restructuring remained outstanding, there would be a continued expectation of a clear depiction of steps and an adjusted indicative schedule, to facilitate a subsequent review.<sup>18</sup> The Fund's Executive Board would have the opportunity, in the context of its Summing Up, to calibrate the message to the debtor and creditors/creditor forum about the urgency in moving through the next envisioned steps.

**26. In line with the proposal to use financing assurances reviews to more effectively monitor progress in debt restructurings,** going forward, the application of strand 1 under the LIOA to arrears arising after the date of adoption of this proposal would also require the completion of a financing assurances review until such arrears are resolved.

### C. Proposed Reforms to the Fund's Financing Assurances Policy

**27. The Fund's financing assurances policy for debt restructuring situations is optimized for the previous official bilateral creditor landscape.**<sup>19</sup> There are two dimensions to consider:

- **Modalities for assessing that financing assurances are in place.** The Fund has a very long history of close collaboration with the PC. The PC's well-developed processes, the underlying creditors' internal processes, and PC creditors' collective track record of timely treatments in line with Fund program parameters allow a simple and straightforward process for assessing that assurances are in place. These are derived from the PC's chair summing up at the end of a Club meeting, based on a working paper and in anticipation of an Agreed Minute. For non-PC creditors, the Fund has sought specific and credible assurances on debt relief/financing. This has come to entail written and/or verbal communication from the creditor, committing to negotiate a treatment to restore debt sustainability consistent with program parameters. However, as noted above, this has often resulted in lengthy processes and frictions with individual creditors due to their domestic legal requirements and constraints. The content of SCAs inevitably differs and could raise questions about comparable treatment across non-PC official creditors. Moreover, the approach falls somewhat short of what is received from Paris Club creditors when the creditor in question does not have the same history of successful and timely delivery of debt treatment standing behind it, again creating uniformity of treatment concerns among creditors.
- **Approach to creditor coordination mechanisms.** The PC plays a unique role in Fund policies as currently the only representative standing forum recognized by the Fund for purposes of the arrears policies. That unique role extends to situations where it cooperates with other creditors ("PC+" agreements, as well as CF agreements where the PC is involved, i.e., due to individual

<sup>18</sup>Such timetable would only be an indication for Fund policy purposes and would have no binding effect on participants in the restructuring. That would be clarified in Staff Reports.

<sup>19</sup>See [reference to the 2022 LIOA review] for a full description of the policy.

member involvement). Fund policy allows engagement with another such forum should it arise, and it would be useful to assess under what circumstances the CF can be considered a representative standing forum under the LIOA policy outside of the context of PC involvement. At the time of the 2022 LIOA policy review, most Directors agreed that more experience is needed in order to recognize the CF as a representative standing forum and welcomed staff's plan to closely monitor the CF's evolution and revert to the Board.<sup>20</sup> In the absence of CF work without PC involvement, staff is not in a position to revert at present.

**28. The issues with the Fund's approach to securing financing assurances are extremely difficult to resolve in the near term.** Individual creditors' internal processes (including legal frameworks) can differ markedly and cannot be expected to change in short order, nor to completely mimic the PC procedures around which Fund policies revolve. Track records also vary considerably, and by definition will take time to change. A potential solution exists in the form of expanding the membership and reach of existing creditor coordination mechanisms (i.e., the PC or CF), and Fund staff will continue to support this, as it is the preferred approach. However, such a change is outside the control of the Fund, and in any event cannot be assumed to be feasible at a near-term horizon.

**29. Against this backdrop, staff has focused on a reform proposal focused on creditor processes that could help mitigate these issues over time.** Staff proposes that the existing requirement for a creditor to commit to deliver a restructuring in line with program parameters be operationalized through an assessment that a "credible official creditor process" (COCP) is in place. This would re-orient the Fund's approach towards a Fund assessment of processes as opposed to the delivery of specific statements by a creditor, eventually eliminating frictions and superfluous steps. Such a judgement about processes would need to be informed by an official creditor's track record of debt treatment delivery. Thus, it would not be immediate, but once such a judgment would be taken it would be assumed to thereafter apply (absent new developments to suggest otherwise). The proposal would apply to all cases where such creditor commitments are currently sought including: (i) pre-default cases; (ii) strand 1 cases where the representative standing forum is giving the Fund assurances; and (iii) the proposed enhanced strand 4 cases where the Fund would seek commitments from a "sufficient set" of creditors.

**30. The reform proposal can be operationalized in a relatively straightforward way.** Staff would need to understand: (i) the steps in the official creditor's internal process; (ii) the key decision makers involved (i.e., those with authority to commit the creditor); (iii) the information provided to inform decision making at the relevant stage (i.e., macroeconomic outlook, debt targets, possible restructuring approaches);<sup>21</sup> and (iv) the timeframe over which the decision would be expected to be executed (which should be in line with the Fund's expectation that a restructuring would be agreed promptly, normally by the time of the first program review). Guidance would stress the need for staff

<sup>20</sup>The Acting Chairman's Summing Up Reviews of the Fund's Sovereign Arrears Policies and Perimeter Executive Board Meeting 22/41, May 4, 2022 (SU 22/65).

<sup>21</sup>Staff would provide the creditor with the information it needs for its internal processes (similarly to the information that is provided to the Paris Club).

to interact with and support a creditor’s internal process (by providing information on a timely basis upon request, and by answering questions). Guidance would defer to the authorities’ representation that a key stage of decision making had been passed, with the aim to just identify the nature of the decision and who took it. Having observed a few cases—the track record—staff would be in a position to establish the credibility of the “key stage” in the specific creditor’s process in terms of delivering outcomes (i.e., contractually finalized debt relief and/or new financing consistent with program parameters).

**31. Defined in this way the application of the COCP standard would mean the same standard, but with slightly different manifestations across different member circumstances:**

- **It would take account of specific features of creditor or creditor coordination mechanisms.** It will be straightforward where the PC is involved, given its track record, including where it is involved via the CF process (and thus would help support use of the CF).<sup>22, 23</sup> In the case of non-PC official bilateral creditors (or the CF without PC involvement) the approach would allow for a faster determination as track record builds (and the key decision-making stages in those processes, and their ability to deliver, become better known). Note that since any restructuring case typically involves multiple non-PC creditors, the process of establishing a track record for each of their processes could in principle move broadly at the same speed.
- **It would take account of the type of treatment being sought from creditors and the track record with such specific treatments.** For example, creditors may (already) have a longer track record for timely Net Present Value (NPV)-neutral reprofiling than for deeper treatments.
- **To further illustrate how it may lead to different judgment across creditors (and over time),** Appendix III describes the internal creditor processes in three PC members (setting aside the inter-creditor coordination stage at the Paris Club).

**32. This proposal to assess COCP for official claims would differ from the existing standard for assessing “private creditor credible process” for restructuring of private claims.**

In the private sector context, there is generally a diverse set of small creditors subject to the contractual framework for resolving debt distress. The debtor country and its advisors play a critical role in managing this process, and the Fund’s assessment can thus focus on the debtor’s actions. The contemplated reforms would not affect the Fund’s approach towards private creditors, which intentionally does not give such debtors a veto over Fund assistance and accepts that arrears may finance the program and may be outstanding for an extended period of time.<sup>24</sup> In contrast, in the official sphere, creditors enjoy greater leverage, including under Fund policies, and there may be

<sup>22</sup>See 2022 Arrears paper, para. 54.

<sup>23</sup>For creditor coordination mechanisms that do not include the participation of a creditor from an existing representative standing forum, the focus should remain on the track record of their delivering timely debt relief, in line with IMF program parameters (per the recent LIOA review).

<sup>24</sup>To the extent that Fund staff assess that there are factors in play that undermine such assumptions, such as private creditor leverage over the debtor, then staff may not be able to conclude that sufficient assurances are in place to proceed (see Box A1.I in [Reviews of the Fund's Sovereign Arrears Policies and Perimeter \(imf.org\)](https://www.imf.org/publications/external/box/2022/01/01/boxa1i)).

significant creditors or groups of creditors with substantial additional leverage over the debtor in the case of hand. In such cases, the debtor's actions can no longer be relied on exclusively to guide the process forward, arrears can no longer be relied on to finance the program or be outstanding for extended periods of time, and a greater focus on the actions of the creditors and their processes is thus needed.

**33. The Board would make the assessment advised by management and staff.** Note that this is no different from what the Board does with an SCA. Importantly the fact that the standard may manifest in different ways in different circumstances implies that any such judgment needs to be made in the context of a specific country case. Management and staff would need to explain to the Board the basis for their judgment, citing the key elements of the process, and explaining the track record. Subsequent similar cases for the same creditor would not need to repeat the full explanation, absent new developments, and would just refer to the attainment of the key stage. Importantly, in the event the committed debt treatment is not delivered in a timely manner or at all, then staff would need to revisit the assessment and key in on a later stage in the creditors' process (looking for evidence that once that later stage is passed a restructuring gets concluded in a timely manner). This constitutes a key safeguard against incorrect application of the COCP (since any incorrect application would not set a precedent or lower bar for future cases).

**34. In the absence of enough information and/or track record to reach a COCP judgment, it could be satisfied by a SCA.** This would ensure a smooth transition to the new regime. Since this would involve continuance of the frictions and problems related to SCAs, Staff Reports would be expected to provide greater context to the SCA, also with a view to help establish the track record needed for an eventual COCP assessment and to ensure that modalities across creditors would be uniformly applied (i.e., that two similarly situated creditors received similar consideration for a credible process assessment).

**35. Once the transition has happened, the approach would make the Fund more agile without taking significant additional risks:**

- It would provide the Fund with a uniform way of interacting with creditors and creditor coordination mechanisms, while accounting for their varied circumstances. Note that the approach can align with the CF's processes (which may in fact be its first application), or with creditors' own processes, rather than imposing a particular form of assurances.
- In principle it can shorten the time needed for arrangement approval or review completion. For example, the Fund, in its assessment, would not need to wait for a creditor to meet the domestic legal requirements for giving SCA. That would allow the Fund to proceed in situations where there is a high degree of certainty that the treatment will materialize, but where SCAs would only be provided after lengthy internal authorizations fully run their course.
- In fact, with a sufficient track record, the Fund may be able to move its assessment earlier in the process. In this context, this could encourage non-PC creditors or any new creditor coordination mechanism to further refine their processes with greater efficiency in mind. And it would provide

a strong incentive to build (and maintain) a track record of two-way communication and collaboration between the Fund and those creditors.

- Finally, it would provide at least as strong a safeguard as the current approach of seeking SCAs (indeed for a mature creditor process, like the PC, the two overlap perfectly). In this context, it is important to note that SCAs also represent a judgment by the Fund (i.e., that the assurance provided will lead to the restructuring outcome desired).

#### D. Proposed Reforms to Pre-Default Policies

**36. Staff proposes extending key elements of financing assurances reforms to a pre-default context.** The same problems that appear in a post-default context exist in a pre-default context: the application of financing assurances requirements in a consistent and even-handed manner; and the depth of consideration given to debtor-creditor developments in program reviews (and whether safeguards remain adequate). The financing assurances requirement is further complicated in a pre-default context by limited guidance about who should provide a SCA i.e., the “materiality” test.<sup>25</sup> Overall, evening out requirements between pre- and post- default is important to avoid arbitrage opportunities across Fund policies. That is, in a pre-default state arrears may well lie ahead (as cooperative creditors push the debtor to stop payouts to other creditors, and sustainability considerations dictate a financing program with little space for repayments until a restructuring deal is reached).

**37. Staff proposes to limit the request for financing assurances pre-default to a “sufficient set” of creditors.** This would be defined in the same way as is proposed for the LIOA policy, strand 4 (see paragraph 22). The remaining creditors would be considered not material for the purposes of the assurances and assumed to restructure on program terms. This would bring transparency to the process of judging that adequate assurances are in place, without loosening the requirement versus present practice nor versus the LIOA approach.

**38. Staff further proposes that, for debt restructuring cases in a pre-default context involving arrears to official creditors, a financing assurances review would be required under the financing assurances policy at each program review until agreement in principle on the debt restructuring agreement has been reached.** In particular, a financing assurances review would help to document at each program review staff’s assessment that the assurances provided about the official sector debt treatment’s progress continue to meet the debt sustainability and financing assurances requirements. At such a review, staff would be expected to consider whether safeguards in place were adequate, and scaling them up, if necessary, in the manner described in paragraph 20, bullet 4.

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<sup>25</sup>See, e.g., Malawi 2023 ECF arrangement. The Malawian authorities sought SCAs from the largest bilateral creditors, which were pivotal for restoring debt sustainability on a forward-looking basis, while continuing to work with all other creditors to achieve a debt treatment consistent with program parameters and CoT.

## E. Proposed Reforms to AIP

**39. The Fund has a procedural tool—AIP—to bridge engagement gaps while safeguards are sought, but it is under-utilized due to design shortcomings.** AIP was not designed to support extended efforts of debtor-creditor engagement in a restructuring context:

- AIP is a procedure that involves a first decision by the Board approving a Fund arrangement in principle based on a complete understanding between the Fund and the member on policies, but where financing assurances have not been secured. Once the financing assurances have been obtained, a second decision of the Board is required for the arrangement to become effective, and this is adopted on a Lapse of Time (LOT) basis. The original 1984 policy called for this second decision to be taken in a period normally not to exceed 30 days from the first decision but recognized that the period should reflect the member’s circumstances.<sup>26</sup> The practice has varied, including some cases where the initial approval did not set a deadline and a few extending the deadline usually on a LOT basis. With the adoption of the 1989 Lending into Arrears policy for private creditors (LIA), the improved coordination among Paris Club creditors, and the adoption of the LIOA policy in 2015, AIP became less relevant, and the 1984 policy itself lapsed, but the practice is still available (with one recent use).<sup>27</sup>
- In any event, AIP as currently designed cannot effectively be used in cases with lengthy creditor processes. AIP is only effective so long as the underlying economic program reflects circumstances on the ground and is being implemented. It can quickly become stale. Even setting aside that targets may be missed, a debt crisis typically involves a large flow of new information and high macroeconomic uncertainty, such that the program framework needs to be regularly updated. This is exactly why the Fund applies quarterly program reviews in cases with fast moving developments.<sup>28</sup> However, a review is not possible under AIP because the arrangement is not legally effective. Thus AIP, as currently designed, can be relied on for a few months at best, which cannot cover the time it takes for lengthy creditor processes to play out, based on recent experience. Not surprisingly it has been used rarely in the last 25 years.

<sup>26</sup>The Chairman’s Concluding Remarks at the Conclusion of the Executive Board’s Discussion of Extended and Stand-by Arrangements—Approval in Principle (BUFF/84/168, 10/24/1984).

<sup>27</sup>During the 1980s, the Executive Board used the Approval in Principle procedure as a mechanism to catalyze agreement between Fund members and both official and private creditors. See Approval in Principle of Fund Arrangements (See [Chapter 1: The 1980s Debt Crisis in: Prevention and Resolution of Sovereign Debt Crises](#) (imf.org), and The Chairman’s Concluding Remarks at the Conclusion of the Executive Board’s Discussion of Extended and Stand-by Arrangements—Approval in Principle. The procedure was used in 2017 for Greece; see: Greece: Request for Stand-By Arrangement-Press Release; Staff Report; and Statement by the Executive Director for Greece. This represents the current practice.

<sup>28</sup>See Decision No. 7925-(85/38), as amended (“For members facing an actual balance of payments crisis that may involve fast moving developments or an uncertain external economic environment, more frequent monitoring on a quarterly basis could be expected.”).

**40. The proposed adjustments to AIP are designed to help it bridge a longer period where needed.**<sup>29</sup> They would set a time period for the AIP to apply, conditions for the AIP to be renewed, and broaden the conditions for the second AIP decision from “financing assurances” to “adequate safeguards” (as defined in the section on LIOA reforms). It would entail specifying several elements:

- The period between approval in principle and effectiveness of an arrangement. The first decision to approve in principle would be required to specify a date by which AIP would lapse, i.e., a deadline by which the second decision must be adopted on a Lapse of Time (LOT) basis. Factors in determining the deadline include the need to ensure that the program would not become stale, the need to ensure that the program was indeed being implemented and the need to ensure that delay would not distort the phasing under the arrangement. This deadline can usefully align with the expected timeline in a program for a review, which is about 3-4 months in rapidly evolving situations.
- A timeframe and circumstances under which the AIP could be renewed. Such a renewal would normally be subject to a limit of 3-4 months (implying a maximum AIP period of 6-8 months) and such an update would only be allowed once with respect to an arrangement request.
- Renewal. An AIP could only be renewed if the use of the AIP tool was still considered worthwhile; that is that the effort to establish necessary safeguards would still be on track and likely to deliver. To complete a renewal, staff would need to assess that the overall program is being implemented and remains on track. Concerning the latter, new information may require minor updates (e.g., to adjust availability dates and test dates), but could also require more significant macroframework updates, and/or updates where there are implementation issues to be corrected. Prior actions would be expected to correct any implementation shortfalls, and could draw on conditions in the original program, with any use consistent with the Guidelines on Conditionality. The proposed extension and new LOI/MEFP/TMU would need to be put forward for full Board consideration, supported by a new staff report. The Board would need to be informed if AIP would be allowed to lapse without renewal or achievement of the second condition, including an explanation of the reasons for this.<sup>30</sup>
- The required safeguards. Under the current AIP, once the necessary financing assurances are obtained and the Fund determines that debt sustainability is being restored on a forward-looking basis, a second decision of the Executive Board (adopted on a LOT basis) is required for the arrangement to become effective. In a restructuring context, the proposals in this paper mean that the new requirements under the financing assurances policy and the LIOA policy would have to be met to proceed. As discussed above, these could be broader than just financing assurances. The Fund would require adequate safeguards to proceed (either

<sup>29</sup>Appendix IV provides an overview of the history and purpose of AIP.

<sup>30</sup>For instance, at the renewal stage in the event it was no longer deemed a useful tool to secure safeguards, conditions were not met for renewal, or in the event of a new program request. Note that the member's right to request a new program at any point would remain, but there would be a strong incentive to stay within AIP to avoid creating questions about capacity to implement a program.

pre- default, or under LIOA). These safeguards accordingly would need to be clearly specified in the conditions required for the second decision under AIP (i.e., to make the arrangement effective) for such a program involving a debt restructuring.

**41. Program design under the proposed adjustments to the AIP framework would need to recognize and be robust to the possibility that the safeguards noted above might only be received during the extended period of the AIP.** This can be handled with suitably conservative financial programming combined with the use of adjusters (i.e., on targets that would be affected if the financing assurances and thus Fund disbursement arrive earlier or later than expected). Note that it would be possible for program design to be based on semi-annual reviews notwithstanding a possible AIP renewal in three months (and in this instance a set of Indicative Targets at the three-month point would be essential to support AIP renewal).

**42. It is important to emphasize that AIP would continue to be a potential tool, not a requirement.** Its use would be governed by the circumstances. In all cases staff should aim to bring a UCT program forward as fast as possible (utilizing the proposed strand 4 under the LIOA reforms, and tools like stand-alone DSA approval to overcome information sharing barriers towards securing safeguards).<sup>31</sup> In some circumstances, consultations with a standing forum, other official bilateral creditors, and the debtor countries' debt advisors may reveal that more time would be needed to secure the necessary safeguards, especially if enhanced safeguards proposed as part of strand 4 are deemed necessary. In these instances, the revised AIP could be a good option to pursue. The Fund's Executive Board would have the opportunity, through the Summing Up, to calibrate the message to the debtor and creditors about the urgency in supplying the necessary safeguards.

## F. Fund Financial Support to Members Facing Exceptional Circumstances

**43. There is a gap in the Fund's ability to support members with urgent BoP needs who are undertaking debt restructurings and have arrears to official creditors.** This reflects the need for greater clarity about the application of the LIOA exceptional circumstances clause, and further guidance about the qualification requirements under the Rapid Credit Facility (RCF) and Rapid Financing Instrument (RFI):<sup>32</sup>

- LIOA exceptional circumstances clause. Under the LIOA policy, in emergency situations such as in the aftermath of a natural disaster, where the extraordinary demands on the affected government are such that there is insufficient time for the debtor to undertake good faith efforts to reach agreement with its creditors, the Fund may provide financing under the RCF or RFI despite arrears owed to official bilateral creditors without assessing whether the LIOA criteria are met or obtaining the creditor's consent. In particular, under this clause it would be expected that "Fund support provided to the debtor...would help advance normalization of relations with

<sup>31</sup>One advantage of AIP versus stand-alone DSAs is that the former provides the full picture of the program.

<sup>32</sup>The Lending into Arrears (LIA) Policy is fully aligned with the LIOA's exceptional circumstances clause since 2022. But the greater flexibility in the LIA (relative to the LIOA) makes it less likely that a case would hinge on such application when it comes to commercial creditors.

official bilateral creditors and the resolution of arrears.” However, staff need to clarify in what circumstances to apply this clause and how to make this judgment, and this takes on added importance when dealing with cases where creditor processes are lengthy and uncertain.

- Applicable RCF/RFI requirements. Any request for EF would need to satisfy qualification requirements under the RCF/RFI. In particular, the RFI and RCF can only be approved where a UCT-quality program is either not necessary (because the BoP need is expected to be resolved within one year and no major policy adjustments are necessary to address underlying BoP difficulties) or not feasible (inability to design or implement a UCT quality program due to the urgent nature of the BoP need or the member’s limited implementation capacity).<sup>33, 34</sup> Thus, qualification requirements would not be met in cases where a UCT-quality program is needed and sufficient implementation capacity exists for such a UCT-quality program, but financing assurances from official bilateral creditors are required and would take time (typically 7–9 months at present) for the program to move forward. This situation would appear to leave the Fund essentially unable to provide EF to such a member experiencing an urgent BoP need and facing a long restructuring and Fund financing engagement process, an important gap in a world where emergencies are expected to become more frequent (e.g., due to extreme climate events).

**44. The “exceptional circumstances” clause in the LIOA policy focuses on emergencies such as natural disasters and applying it would require a clarification of what could constitute such emergencies.** Emergencies could in theory cover exogenous and endogenous shocks. Staff proposes to focus on exogenous shocks (e.g., adverse shocks to key commodity markets or even developments with or in a key trading partner), and natural disasters (e.g., hurricane, widespread flooding, etc.). Otherwise, staff would not propose to define a precise set of events nor specific triggers, consistent with the standard Fund policy on emergency financing which leaves room for some judgment. Importantly, staff would not propose to cover urgent BoP impacts arising from sources common to all restructuring situations (i.e., the policy-driven endogenous dynamics of a debt crisis), because debtor-creditor engagement to resolve those arrears is the whole essence of addressing the crisis. Note that, under existing RCF/RFI policy, the projected BoP impact of the shock would define access, up to the applicable EF limits and subject to the relevant policies.

**45. To apply the “exceptional circumstances” clause under the LIOA policy also requires a judgment about debt resolution prospects.** The requirement that “Fund support to the debtor

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<sup>33</sup>The RFI Instrument requires, in relevant part, that such financing is only available if “the member either (i) has a balance of payments need that is expected to be resolved within one year with no major policy adjustments being necessary, or (ii) is unable to design or implement an Upper Credit Tranche (UCT)-quality economic program given the urgent nature of the balance of payments need or due to its limited implementation capacity”. Decision No. 15015-(11/112), as amended.

<sup>34</sup>The PRGT Instrument provides, in relevant part, that, before providing financing under the RCF, the Trustee must be satisfied “normally, that the member either (i) has a balance of payments need that is expected to be resolved within one year with no major policy adjustments being necessary, or (ii) lacks capacity to implement an upper credit tranche-quality economic program owing to its limited policy implementation capacity or the urgent nature of its balance of payments need.” Annex to Decision No. 8759-(87/176), as amended, Section II, Paragraph 1. (d)(2)(c).

would be expected to advance normalization of relations with official bilateral creditors and resolution of the arrears” was not set as a high bar given that there is insufficient time for the debtor to undertake good faith efforts due to the extraordinary demands on the affected government in emergency situations. The Fund essentially chose to have a higher risk tolerance in such situations. However, this needs to be clarified. Staff would thus propose that this requirement be assessed based on a commitment from the debtor authorities in the LOI to not only make good faith efforts towards resolving the arrears, but also to conduct themselves in a way to promote and encourage creditor coordination (e.g., a commitment to CoT). However, for countries facing emergency situations with long standing arrears experience shows that it is difficult to assert that Fund support would help normalization of relations with creditors and of arrears. It would also be difficult to say that there has been insufficient time for the debtor to undertake good faith efforts to reach agreement with its creditors. In these instances, and consistent with current practice, additional safeguards would be needed for the Fund to provide EF. For post-default cases, this would mean application of one of the three strands under the LIOA; in the pre-default context, capacity to repay assurances would be needed (i.e., per Iraq 2006).

**46. Regarding RCF and RFI qualification requirements, staff proposes no change, and to just provide additional guidance on how to apply them in emergency financing situations in a restructuring context.** In a typical restructuring situation, the member is already engaged with the Fund when faced by an emergency situation and may even have reached an SLA or AIP. This has been seen as a signal that a UCT program is needed and feasible. However, the emergency situation arising after such an SLA/AIP would render the SLA or AIP invalid and require the program to be redesigned. In this context, an infeasible combination of more adjustment and lower total financing would be necessary in order to meet the financing assurances/safeguards requirement for an immediate UCT program. Thus, a UCT program could not be designed within the emergency timeframe and the infeasibility test would be met. The additional guidance would clarify this understanding.

**47. It is important to emphasize that even in an emergency situation the best course of action in a restructuring situation remains to work towards a UCT quality program.** This is generally the form of assistance that members need to help them address such situations (anchoring policies, helping to catalyze new finance, and involving the right volume of Fund support on the right terms and conditions). Thus, for a member undergoing a debt restructuring and in arrears to official creditors, if an urgent BoP need does arise (and requirements under the RCF/RFI and the LIOA exceptional circumstances clause are met), it is essential that the provision of EF should not undermine any broader effort underway to secure a UCT quality program.

**48. The proposed clarification of the exceptional circumstances clause and RCF/RFI guidance would not affect the effort to ultimately secure a UCT program.** To the extent the emergency has raised doubts about the authorities’ capacity to implement a UCT program (e.g., because of political developments and/or emergency policy requirements overpowering standard Fund program objectives), then consistent with existing Fund policies a staff monitored program or PMB would be appropriate to help (re-)establish a policy track record for a UCT

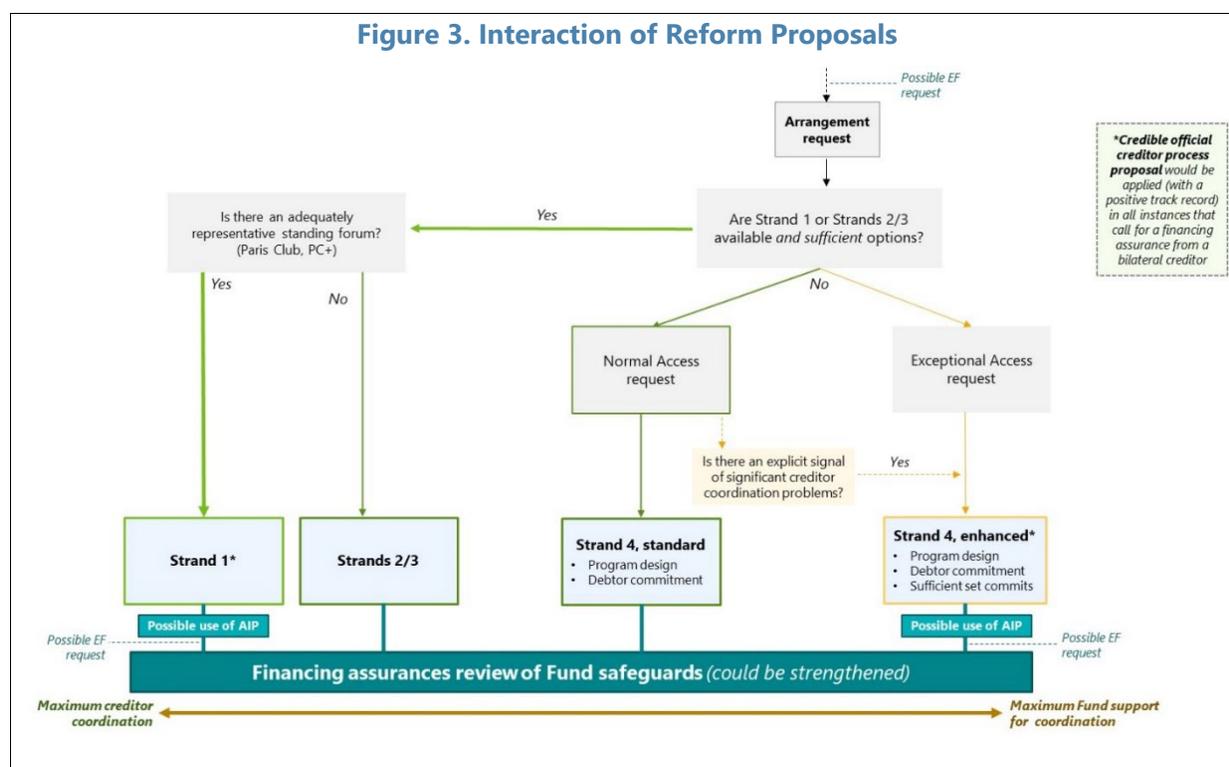
arrangement. Where there are no assessed implementation capacity problems, the policy proposal on AIP would help. For countries which had secured AIP, there would already be a built-in expectation that the program would be updated and renewed (promoting continuity in the dialogue towards a new program). For countries which just have an SLA, or where an SLA has not yet been reached, guidance can set a strong expectation of renewed engagement towards an arrangement. In any of these cases, the letter of intent for the EF should contain any macro critical actions identified in the SLA/AIP and these could involve prior actions where warranted, further ensuring continuity towards an arrangement.

## G. Summary of the Package of Proposals and Its Implications for Fund Engagement and Safeguards

**49. Under the reform proposals laid out above, the Fund’s modalities for engagement in a debt crisis would be notably clarified (Figure 3).** The current pathways would remain available:

(i) an adequately representative agreement involving a representative standing forum (strand 1);  
(ii) consent (strand 2) with perhaps the application of the three criteria to some creditors; and  
(iii) application of the three criteria, subject to existing guidance as elaborated in paragraph 16 (strand 3). When the current pathways would not be available, there would be a standard approach to additional safeguards, available when normal access is proposed; and an enhanced approach to additional safeguards when exceptional access is proposed, or when creditor signals point to a need for greater Fund support for coordination. The Staff Report would fully articulate the rationale for the strand and approach followed. Note that all of this can be done under current Fund policy, but clarifying how to apply additional safeguards is critical to ensure that the Fund’s approach is well calibrated to the circumstances, readily explainable, and that members are treated even-handedly (without creditor inter-dependencies blurring the rationales).

**50. Importantly, the proposals scale the use of the Fund’s leverage and its safeguards to the circumstance.** The two different approaches to safeguards under proposed strand 4 (i.e., (iii) and (iv)) directly achieve this at arrangement approval. The reforms to financing assurances reviews would ensure that expected progress within the program period is well-defined at the outset, and that if progress lags the safeguards are scaled up accordingly in a calibrated fashion.



**51. The package can help ensure that the Fund does not get caught in an engagement limbo when a path forward to medium-term viability has been identified.** The indeterminate period between SLA and arrangement approval, and delays in program reviews, have been a key problem for the Fund, for creditors and for the debtor country. Strands 2/3 and strand 4 (standard) would be able to proceed rapidly to allow approval of an arrangement or completion of a review. Strands 1 or strand 4 (enhanced) could require time, but the revised AIP tool can be utilized to rapidly move the situation into a formal engagement. Moreover, if urgent needs arise due to exceptional circumstances, such as a natural disaster, the LIOA/EF clarifications and guidance give the Fund a way to provide EF notwithstanding arrears to official bilateral creditors (and while not disrupting the overall effort to support the members’ restructuring efforts through a UCT program). Finally, at the financing assurances review stage, clarity would be provided about how to deal with lagging progress, promoting faster solutions. Note that it is expected that the use of AIP and EF would be limited, as programs will move more quickly to the approval of an arrangement with the proposed approach under LIOA strand 4, and once creditor processes become more established.

**52. The package of proposed reforms would complement and underpin the existing architecture.** The Fund would continue to seek the involvement of a representative standing forum as a first priority. Note that a standing forum is always possible in theory when any PC creditor is involved, with a key question being whether it can be established to represent a majority of finance during the program period in practice. This does leave room for strand 4 to be applied while efforts continue to establish representativeness, but this would need to be guided by communications with the standing forum. And to the extent representativeness is later established, strand 1 would thereafter automatically apply (with any agreed program conditionality on process adjusted to

reflect the intended timeline and approach of the representative standing forum). Beyond strand 4, the revised AIP approach and LIOA/EF clarification and guidance would be well-positioned to assist in circumstances where a standing forum requires time to deliver assurances (e.g., the CF process). And the financing assurances review proposal is well designed to adjust (and scale up) the safeguards as needed, based on an understanding of where the process stands and expected next steps.

**53. The Fund would continue to collaborate with official bilateral creditors and be able to better account for their internal processes.** Collaboration is critical in that the Fund and debtor cannot alone solve the debtor's problems when a debt restructuring is needed. First, the Fund would move to strand 4 based on creditor signals, and within strand 4 would be guided to the form of safeguards by creditor communications (outside of exceptional access). This is important as creditors are in a better position to observe the type of support, they need from the Fund for their coordination efforts. Second, the shift in the modality for financing assurances from official bilateral creditors to an assessment that an COCP is in place would help account for creditors' different internal processes. This assessment would align with existing internal processes for current standing fora, and likely reduce timelines for and frictions with non-PC creditors, while leveling the playing field across creditors/creditor groups. Note that this aspect of the proposal would take time to come into full effect, implying a transition away from SCA. On the flipside, once it does come into full effect it would reduce the need for using AIP, and perhaps even the need for LIOA if UCT programs can be approved before arrears materialize.

**54. Overall, the package of reforms can help incentivize a faster official creditor restructuring process.** The proposals to strengthen safeguards represent a good use of the Fund's leverage to this end. In particular, the Fund would help overcome first-mover problems by securing commitments from the debtor to good faith efforts and by using conditionality to support a process for the restructuring (and adjust these as necessary at financing assurances reviews). The Fund would directly seek creditors' commitments where necessary to get the process moving and also shift this to a different and faster modality over time (an assessment of COCP). And the Fund would use AIP to nudge both the debtor and creditors in the right direction when indications arose that time would be necessary to initiate the restructuring process.

**55. The package should preserve the relative leverage of official and private creditors under Fund policies but should help support more efficient private-sector processes.** The proposals do not change the way the credible creditor process and good faith tests would be applied in the context of restructuring of privately held debt. The private sector would continue to not have a veto over Fund support. However, the revised engagement approaches should get information about the program into the public domain much faster, including the debt sustainability assessment and targets. This is a key input into private sector deliberations. As such, it would provide the option for them to seek an early agreement based on program parameters and an understanding about comparability of treatment (with the authorities' commitment also set to be expressed publicly under strand 4). To the extent the private sector or the authorities wish to wait for the official-sector process to conclude, the reforms should ensure that the latter proceeds faster,

as noted above. The proposals for the Fund to better support CoT—which cover both the authorities’ commitment to good faith efforts and the proposed treatment of new arrears due to CoT violations under the Fund’s non-toleration of arrears policy—would promote creditor confidence in following different sequencings.

**56. The revised modalities would be effective immediately upon approval by the Executive Board.** They would be reflected in the guidance on lending into arrears and lending into official arrears (which is expected to be completed early in FY25), and in the staff guidance on the Guidelines on Conditionality when these are next revised. Note that for programs already underway where a debt restructuring is being supported, the provisions concerning financing assurances reviews would apply.

**57. The proposals are expected on balance to have a small positive budgetary impact for the Fund.** They would have little further net policy development or training cost (since LIOA guidance and training is already in the work program). On an operational basis, the reforms would be expected to reduce Fund workload. The policy changes would remove ambiguities in policy that at present generate a need for extensive discussions within staff, with creditors, and with the Board. To the extent that creditors better understand the Fund’s requirements and adapt their processes over time to better work with the Fund, the benefits would be higher. Of course, the precise size of any benefit would be linked to how many new cases will be forthcoming, and the Fund does not predict such cases in its WEO baseline (the existing Ethiopia case would be the main application). So, the baseline benefit is seen as small, but budgetary benefits would likely be substantially higher in a global downside scenario.

Reform Proposal	Objective	Proposal	Outcome for Fund Safeguards	Intended outcome for Fund's member needs
1 <b>Introduce Strand 4 to LIOA</b>	To allow Fund assistance to proceed with safeguards in the presence of creditor coordination problems	Introduce to the LIOA policy a 4th strand that consists of three safeguards, to be applied when issues arise preventing existing strands 1-3 from being applied by themselves: 1. Program design to facilitate creditor commitment 2. Debtor commitments 3. Creditor commitments (by a sufficient set)	Supports adequate safeguards in situations where creditor coordination problems pose challenges.	Incentivizes faster progress, with the Fund working with creditors, supporting their coordination, or de facto facilitating it as needed. Allows for the Fund to proceed with adequate safeguards sooner in the presence of creditor coordination challenges.
2 <b>Deepen financing assurances review</b>	To make financing assurances reviews more transparent and effective in restructuring cases	Strengthen the financing assurances review at program approval and subsequent reviews by including a clear depiction of steps and schedule of the restructuring process. During reviews, updates on progress will motivate any requirements for additional safeguards under LIOA strands 1-4. In addition, require financing assurances reviews in a pre-default context until restructuring agreement is reached.	Supports adequate safeguards by aligning financing assurances reviews to the restructuring timetable and adjusting needed safeguards based on progress in the restructuring process.	Aligns program with the expected restructuring process (informed by consultations with advisors and creditors) and incentivizes debtor commitment and creditor engagement.
3 <b>Modify financing assurances policy</b>	To make the Fund's modalities for receiving assurances flexible across different creditors' internal processes	Use an assessment that a "credible official creditor process" (COCP) is underway to derive financing assurances from a sufficient set of creditors. If a creditor establishes a positive track record of its process for providing specific and credible assurances (SCA), its COCP can replace the current SCA standard. Until then, SCA continues to apply as the means to establish COCP.	Safeguards are better calibrated. Under COCP, modalities for satisfying the Fund's Financing Assurances Policy are aligned with a range of creditor's internal processes for providing financing assurances	Over time, allows for the Fund to proceed faster and aligns the financing assurances policy to a variety of creditor processes beyond the PC.
4 <b>Update Approval in Principle tool (AIP)</b>	To allow for AIP to be a potential tool in cases with lengthy creditor processes	Adjust AIP to allow it to be renewed once, subject to meeting some conditions (similar to requirements for completing a program review); broaden the condition for the program to become effective from "financing assurances" to "establishment of adequate safeguards", with the latter covering those required under proposed LIOA strand 4.	Unchanged, but makes the establishment of safeguards required by the LIOA policy more transparent.	Facilitates high frequency dialogue with both the member and its creditors and involves the IMF Board during what would otherwise be a long period between SLA and program approval.
5 <b>Clarify emergency financing channels for restructuring cases</b>	To provide guidance for the provision of emergency financing in response to disasters or exogenous shocks for countries undergoing restructurings	For an urgent BOP need, such as a natural disaster, that arises for a member negotiating a program in the midst of a restructuring case, clarify the application of the LIOA's "exceptional circumstances clause" and clarify the guidance for use of the RFI/RCF (with the recognition that there exists an "inability to design" a UCT program in a short and urgent timeframe).	No change in safeguards or policy, but rather clearer policy and guidance on how to extend emergency financing when a member is already under, or negotiating, a UCT program.	Support a member facing a natural disaster or exogenous shock and allow more time for creditor processes to play out.

Table 1. Summary of Proposals

## ENTERPRISE RISK ASSESSMENT

**58. Staff views the proposed reforms covering the financing assurances review and AIP procedures as on balance reducing risks to the Fund.** These would reduce reputational risks (by clarifying the Fund’s approach and avoiding perceptions of inaction), the business risk of member engagement (i.e., that creditor or debtor countries perceive the timing, modality, traction, or agility of the proposed policy as inadequate and disengage from restructuring negotiations), and financial risks (by building in more systematic efforts at securing safeguards). Note that the risk that engagements will be drawn out has already materialized, and this proposal responds to that.

**59. Proceeding with the proposed LIOA policy, financing assurances policy, and EF reforms involve risks to the Fund, including:**

- a. **Reputational objectivity risk.** The Fund faces a reputational objectivity risk if proposals do not lead to faster restructurings. The Fund could be seen as having granted unwarranted accommodation to official bilateral creditors and slowing down private debt resolutions. The Fund could also face pressure to make unwarranted assessments of COCP where the conditions to support this are not fully in place, including to avoid being perceived as the source of delay.

*Mitigants:* This is an unlikely risk, given where the situation is right now: most of these concerns already exist and the proposals would not make them worse. Indeed the risk is mitigated by the incentives the proposals build toward faster restructuring processes (see paragraphs 54–55), and by the strong ‘snap back’ mechanisms in the policy if creditors do not make progress in debt restructuring (e.g., increased effectiveness of financing assurances reviews, the ability to route future case through a higher LIOA safeguards standard, and the built-in ability to revert the COCP assessment in future cases, if necessary, based on developments).

- b. **Credit risk.** The Fund faces implementation risks that could end up making debt situations worse by, inter alia, loading countries with super-senior debt alongside creditors unwilling to restructure. This could occur under different proposals in the following ways:
  - i. Under the LIOA strand 4 proposals, it is possible that creditors failure to provide an answer on consent sends the Fund into the standard safeguards approach for normal access, creating financial exposures in a situation where creditors actually have no intention of restructuring. Given recent cooperation with creditors, staff considers this unlikely.

*Mitigants:* Financial risks in implementation are manageable in consideration of: (a) the low initial access allowed; (b) the greater clarity at the financing assurances review stage (where the problem would be confronted). It is also very important to note that this problem can already appear under current Fund policies, and the proposals provide a

framework to mitigate this that much more closely and transparently links safeguards to underlying risks.

- ii. Under the COCP proposal, mistaken judgments would leave the Fund with financial exposures to a debtor in debt distress, who in turn will face delays in resolving its balance of payments problem. Given the transition period, this is not an immediate risk, though it could be important down the line.

*Mitigants:* Financial risks in implementation are manageable in consideration of: (a) the broader safeguards envisioned under LIOA strand 4; (b) the requirement that sufficient information be available to make an COCP judgement (implying some transition in building a track record); and (c) the other non-debt related conditionality under Fund arrangements (which strengthen the debtor's solvency).

- iii. Under the Emergency Financing (EF) proposal, the debtor's pursuit of EF could stand in the way of a UCT program if the debtor and bilateral official creditors do not set a course towards adequate debt relief. In this case, the Fund would be left with financial exposures to a debtor in debt distress which will then further complicate its balance of payments problem. This is an important risk, but one considered unlikely given the relative benefits of EF versus debt relief.

*Mitigants:* Financial risks in implementation are manageable in consideration of: (a) the focus on a subset of emergency situations, such as natural disasters, where official arrears exist; (b) the limited exposure in EF via access limits; (c) the clearer interpretation placed on "normalizing relations with creditors" for the LIOA's extraordinary circumstances" clause; and (d) where relevant, the expectation and modalities for further engagement towards a UCT arrangement. Additional tailored safeguards via LOI commitments would also be available.

- c. ***Adequacy and liquidity of Fund lending resources.*** The Fund could face questions about this if the proposed policy results in broader use of emergency financing by members undergoing debt restructurings when they collectively face exceptional circumstances (e.g., a global shock). Such scenario is likely at some point but is not an important risk.

*Mitigants:* The liquidity risks of EF were shown to be manageable in the pandemic (where usage far exceeds anything that could happen under this proposal, as it would only cover a subset of cases where debt distress prevails, including official arrears, and an exogenous shock has occurred).

## **60. Not introducing the proposed LIOA, financing assurances, and EF reforms would also carry risks to the Fund:**

### **a. Reputational risks:**

- i. ***Reputational credibility.*** The Fund's credibility could suffer from not being able to support members in need, including in emergencies, and from not being able to work effectively with all creditors.

- ii. **Reputational objectivity.** The Fund's objectivity could suffer from external audiences coming to believe that the Fund lacks uniformity of treatment in lending to its membership and does not afford the same treatment across different official bilateral creditors. The Fund's inability to adapt its requirements to different creditor processes could further erode the Fund's reputational objectivity.

*Mitigants:* These reputational risks are already materializing, with credibility risks near certain at the moment and objectivity risks very likely. Communications have proven to be not fully effective at mitigating these risks, though could get more traction with each case that delivers. Proceeding with the proposed reforms would offer some reprieve.

- b. **Credit risks from non-engagement.** In cases where the Fund already has some exposure and is prevented from or delayed in further engagement with the member, the member's capacity to repay the Fund could erode, increasing risks associated with the Fund's existing exposure at the same time as the Fund is unable to help the member resolve its medium-term viability challenge.

*Mitigants:* Proceed with the proposed package of reforms to facilitate timely and more efficient Fund engagement while preserving safeguards (indeed the members' policy adjustment program of a UCT quality is a key safeguard, so better engagement is critical).

- c. **Business risk on member engagement.** Inaction, or excessively delayed action, could lead to spillovers to the Fund's wider membership. Creditor or debtor countries may perceive that timing, modality, traction, or agility of existing policy is inadequate and delay their efforts to address unsustainable debt burdens. This would contribute towards a building debt crisis, with eventual contagion.

*Mitigants:* Proceed with the proposed package of reforms. Communications could be used to explain and defend the Fund's policies and actions but would only get more traction once there are more cases that have delivered.

**61. The balance of risks supports proceeding with the full package of reforms.** See Appendix VI for a full DRSA. The changes to AIP and financing assurances reviews would reduce risks to the Fund on balance. For the LIOA, financing assurances and emergency financing proposals, staff sees a lower risk in proceeding, with direct benefits, plus the feasibility of mitigating risks with proposed reforms and difficulty of mitigating key risks without proposed reforms

## ISSUES FOR DISCUSSION

Do Directors agree that, notwithstanding progress in recent cases, the Fund's ability to meet a member's BOP needs may be constrained when we engage in debt restructuring situations involving new major creditors?

Do Directors support preserving existing guidance on application of the current LIOA strands (including the third strand where the three criteria must be met)?

Do Directors support the proposed addition of a fourth strand to the LIOA policy clarifying how to apply safeguards when the three existing strands cannot provide a pathway forward, including an expectation that under normal access the standard approach would apply absent creditor signals?

Do Directors support strengthening financing assurances reviews to make them more effective under the LIOA policy, as described in paragraphs 25–26?

Do Directors support the proposed adjustments the Fund's pre-default policies, including the requirements about the set of creditors to provide a commitment and introducing pre-default financing assurances reviews into the financing assurances policy?

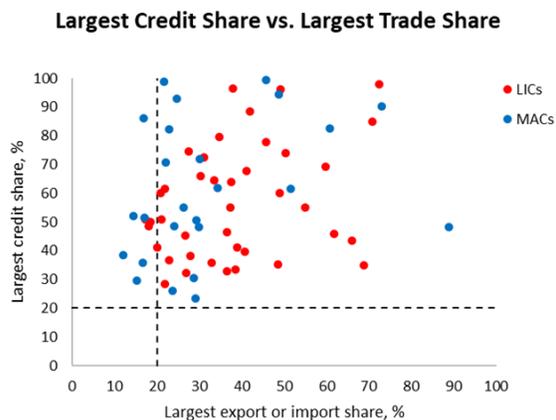
Do Directors support adjusting the standard for judging that a creditor commitment to provide debt relief or new financing is in line with program parameters, by shifting to a "credible official creditor process" assessment?

Do Directors support the proposed modifications to the AIP policy set forth in paragraphs 40–42?

Do Directors support the proposed clarification and guidance on the "exceptional circumstances" clause in the LIOA policy to better facilitate emergency financing, where the extraordinary demands on the affected government are such that there is insufficient time for the debtor to undertake good faith efforts to reach agreement with its creditors?

## Appendix I. Size of Main Trade and Bilateral Financing Partner

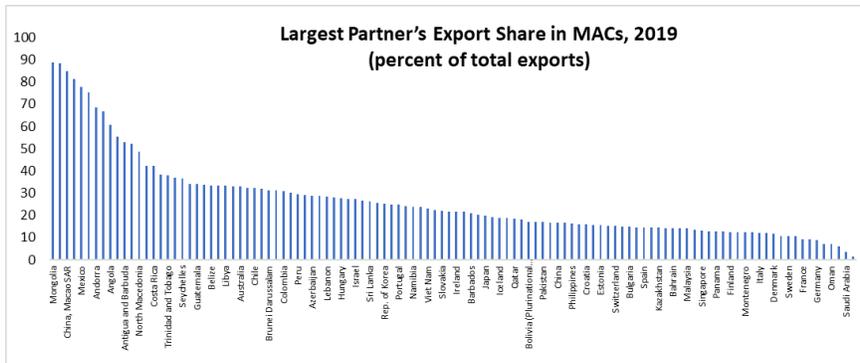
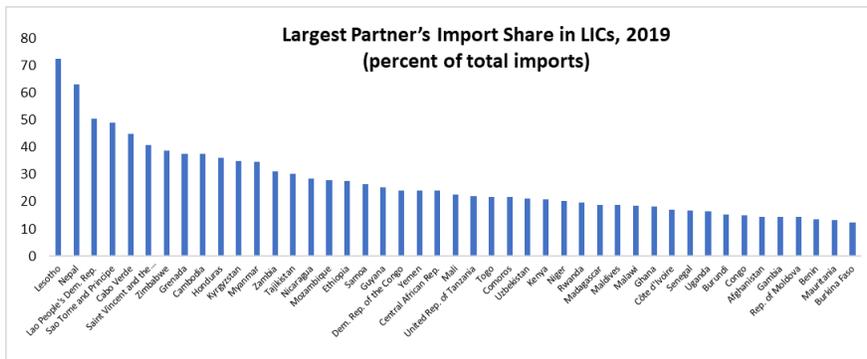
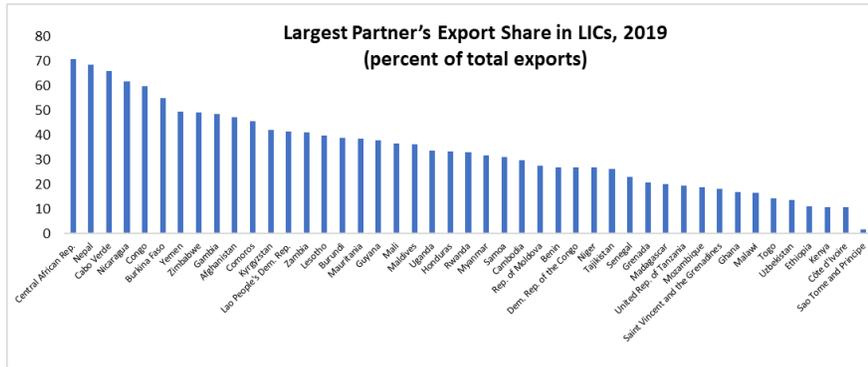
**Figure AI.1. Share of the Largest Bilateral Creditor and the Largest Trade Partner for LICs and MACs**



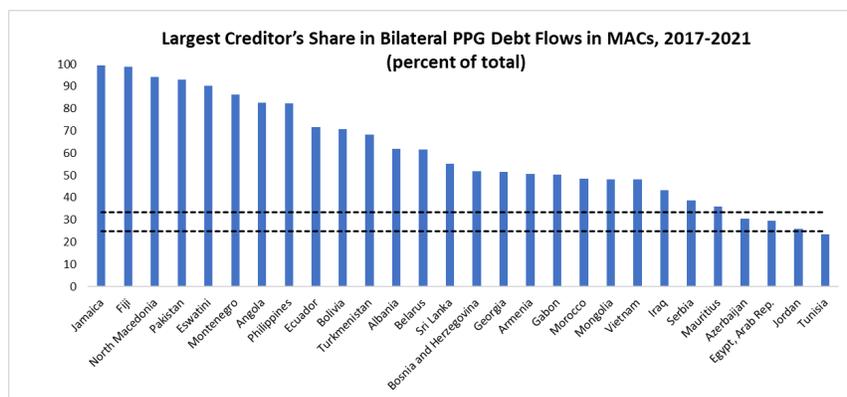
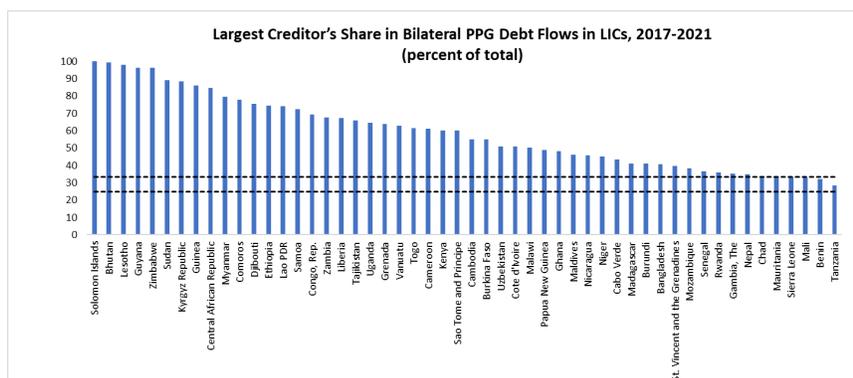
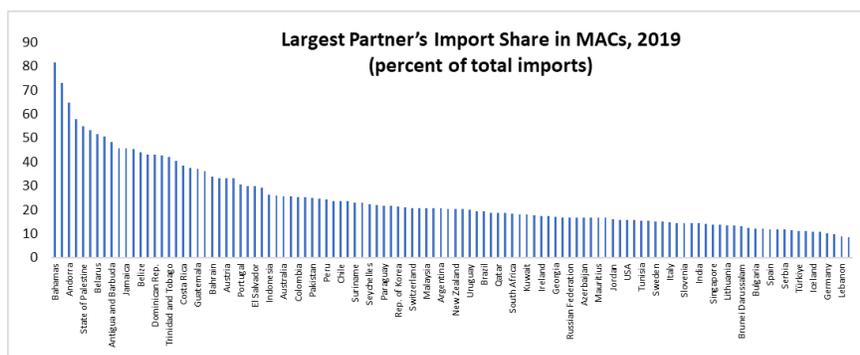
Sources: World Bank's International Debt Statistics database, and UN Comtrade.

Note: Credit shares are computed based on cumulative date over 2017–21. Debtors with cumulative flows of less than 1% of 2021 GDP are excluded. Flows are bilateral PPG disbursements (drawings by the borrower on loan commitments). Exports and imports cover 2019 and include goods and, where available, services data.

Figure AI.2. Largest Trade and Credit Shares 1/ 2/



**Figure AI.2. Largest Trade and Credit Shares (concluded)**



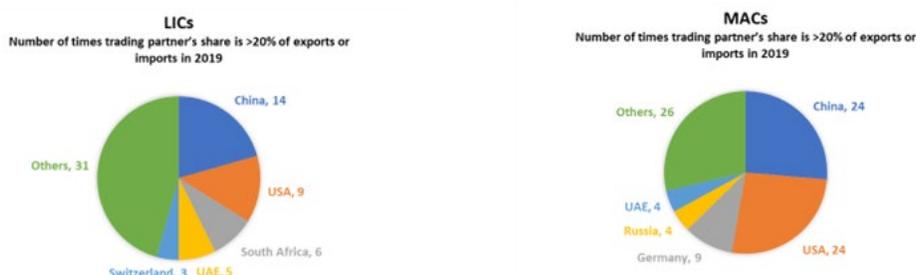
Sources: World Bank's International Debt Statistics database, and UN Comtrade database.  
 1/ Exports and imports cover goods and, where available, services.  
 2/ Based on cumulative data over 2017–21. Cases with cumulative flows of less than 1% of 2021 GDP are excluded. Flows are bilateral PPG disbursements (drawings by the borrower on loan commitments).

**Figure AI.3. Number of Cases for Which a Creditor:**

Accounts for Over 20 Percent of Bilateral Debt Flows Over 2017-21 1/



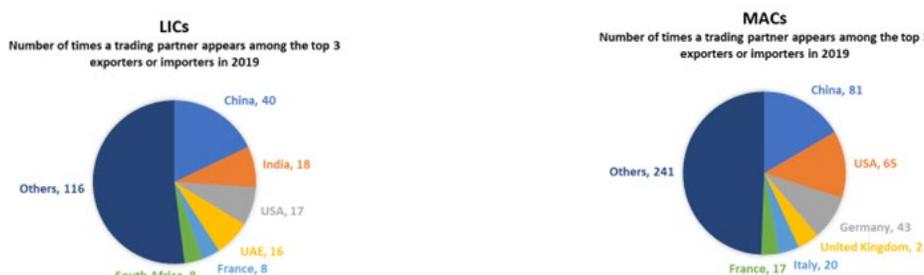
Accounts for over 20 Percent of Either Exports or Imports in 2019 2/



Is Among the Top Three Bilateral Creditors by Debt Flows Over 2017-21 1/



Is Among the Top Three Trade Partners in 2019 3/



Sources: World Bank's International Debt Statistics database, and UN Comtrade database.

1/Cases with cumulative flows of less than 1% of 2021 GDP are excluded. Flows are bilateral PPG disbursements (drawings by the borrower on loan commitments).

2/Exports and imports cover goods and, where available, services.

3/Based on the maximum share of exports in total exports or imports in total imports by partner. Exports and imports cover goods and, where available, services.

## Appendix II. Conditionality and Program Commitments in Fund Programs Involving Restructuring of Private Creditors

Country	IMF Program	Year	Restructuring Type	Form	Finalization/ Intermediate	Specific language	Notes
Ghana	ECF	2023	Domestic & External, latter post default	LOI/MEFP commitment	Intermediate	<ul style="list-style-type: none"> <li>Restoring public debt sustainability through a combination of a comprehensive debt restructuring and an ambitious, growth-friendly, and lasting fiscal adjustment. In particular, we will anchor our policies on regaining a moderate risk of debt distress (based on the IMF-World Bank LIC-DSF) by 2028.</li> <li>We are committed to completing the comprehensive public debt restructuring operation launched in December 2022 to restore public debt sustainability.</li> </ul>	MEFP also report completion of restructuring of marketable domestic debt within the perimeter of the operation
Sri Lanka	EFF	2023	Domestic & External, latter post default	LOI/MEFP commitment	Intermediate	(iii) a sovereign debt restructuring strategy aimed at restoring public debt sustainability	
Zambia	ECF	2022	External, post-default	LOI/MEFP commitment	Finalization	We are committed to finalizing the MOU with official creditors by the time of the first program review, and <b>reaching agreements on comparable terms with other creditors</b> soon after, by the time of the second review at the latest.	
Suriname	EFF	2021	External, [pre-emptive]	None	Intermediate	<p><b>The government is committed to putting public debt onto a sustainable path.</b></p> <ul style="list-style-type: none"> <li>This will require debt relief from creditors and the government has approached both official and commercial creditors to initiate orderly restructuring discussions. The government appointed financial and legal advisors in September 2020 to negotiate the restructuring of the privatelyheld external debt.</li> </ul>	MEFP reports efforts to engage with private creditors in good faith, but does not provide a timeline for specific steps/finalization
Chad	ECF (EA)	2021	External, pre-emptive	LOI/MEFP commitment	Finalization	The authorities are committed to finalizing the MOUs with official creditors, and to <b>reaching an agreement on comparable terms with the largest private creditor</b> , by the time of the first review.	
Ecuador	EFF	2020	External, pre-emptive	None	n/a	<p><b>Our government is committed to restoring the sustainability of Ecuador's fiscal accounts and leave the next administration with stronger institutions and a more robust public financial management framework.</b> Our proactive and market friendly initiative to restructure our international bonds of \$17.4 billion, which received more than 98 percent consent from the bondholders, is a testament to this commitment</p>	Debt exchange completed prior to Staff Report issuance. Staff level agreement was announced on 28 August, just before settlement deadline for the exchange.
Ecuador	RFI	2020	External, pre-emptive	LOI/MEFP commitment	Intermediate	to ensure that public debt remains on a sustainable path and rein in large and protracted financing gaps, we are in the process of implementing a comprehensive debt management plan. In particular, on Friday April 17 bondholders accepted a consent solicitation put forward by the Republic to defer all payments worth over USD 800 million, until August 15. During this grace period, <b>we will work with our advisors, to put forward a second consent solicitation to the market to restructure Ecuador's outstanding debt.</b>	
Congo, Rep. of	ECF	2019-	External, post-default	LOI/MEFP commitment	Finalization	The authorities are committed to <b>completing the restructuring of external commercial debt and domestic debt</b> by the time of the first program review	MEFP commitment to agree restructuring by the first review
Ethiopia	ECF	2019	External, pre-emptive	LOI/MEFP commitment	Finalization	To complement the strong control of external borrowing that has been in place for the last couple of years now, the government also proactively undertook operations to reprofile some of the external bilateral debt held by SOEs. These efforts, which involved a combination of lengthening grace periods and loan maturities, and, in some cases, lowering interest rates, is expected to see a reduction in debt service payments over the immediate term	Steps undertaken to reduce debt vulnerabilities

Country	IMF Program	Year	Restructuring Type	Form	Finalization/ Intermediate	Specific language	Notes
Mozambique	RFI	2019	External, post-default	None	n/a		No PAs, but agreement in principle with a group of Eurobond holders had been reached prior to the request. Restructuring discussions on another private loan were described as "almost finalized" in SR (this was never finalized, and Mozambique subsequently disputed the debt).
Barbados	EFF	2018	Domestic & external, latter post-default	Prior Action	Intermediate	Government to <b>launch exchange offer</b> for debt restructuring of the stock of central government domestic debt held by private creditors and eligible for debt restructuring consistent with EFF supported program objectives.	Conditionality did not cover external debt restructuring, but program request MEFP reported intention to table an exchange offer shortly
Mongolia	EFF	2017	External, pre-emptive	None	n/a		Debt exchange completed prior to Staff Report issuance, mentioned as needed for financing assurances in staff level agreement.
Chad	ECF	2017	External, pre-default	LOI/MEFP commitment	n/a	The Government is determined to <b>reach the necessary restructuring</b> by the time of the first review of the requested program.	
Ukraine	EFF (EA)	2015	External, pre-emptive	Prior Action	Intermediate	Government will <b>hire financial and legal advisors</b> to facilitate consultations with holders of public sector debt with a view to improving medium-term debt sustainability	MEFP also reported intention to finalize the debt operation by the first review
Grenada	ECF	2014	Domestic & External, post default	Prior Action	Intermediate	Consistent <b>with the financing envelope of the program, satisfactory progress in negotiations with the creditors</b> , through: (i) initiating the negotiation phase of the restructuring with private and bilateral official creditors, (ii) seeking agreement on a debt restructuring consistent with closing the financing gap under the program and reducing debt to 60 percent of GDP by 2020; (iii) obtaining financing assurances from the Paris Club; and (iv) developing a credible timetable for advancing the restructuring discussions with private creditors through mid-2014.	
Cyprus	EFF	2013	Domestic, pre-emptive	Structural Benchmark	Finalization	<b>Roll over and extend the maturity</b> of at least €1 billion of domestic debt held by residents through a voluntary debt exchange covering maturities falling due in 2013-15 and roll over the €1.9 billion recapitalization bond of CPB by [First Review].	
Jamaica	EFF	2013	Domestic, pre-emptive	Prior Action	Finalization	Government to <b>complete a debt exchange</b> for domestic government bonds consistent with a reduction in the public debt-to-GDP ratio by 2020 equivalent to at least 8.5 percent of GDP.	

Country	IMF Program	Year	Restructuring Type	Form	Finalization/ Intermediate	Specific language	Notes
Greece	EFF (EA)	2012	Domestic & External, pre-emptive	Prior Action	Finalization	<b>Close a debt exchange</b> with private bond holders prior to the approval of the arrangement	Not in PA/SB table, but SR explicitly mentions as a PA
Greece	SBA (EA)	2011	Domestic & External, pre-emptive	LOI/MEFP commitment	n/a	To support these efforts with an appropriate level of financing, we have defined a strategy to achieve substantial and credible contributions from the private sector and official sectors. In this context we will aim to <b>finalize the relative contributions by private creditors and the official sector</b> by the time of the Fifth Review.	At the time of the 4th review, the need for PSI was made explicit, but SR only had an MEFP commitment to seek financing contributions from the private and official sectors (respective contributions yet to be specified), reflecting the still ongoing discussions within the official sector on the design and extent of the debt operation, against background of fears of contagion
St Kitts and Nevis	SBA (EA)	2011	External, post-default	Prior Action	Intermediate	(1) Authorities <b>commit publicly</b> to undertake a debt restructuring (2) <b>Appointment of legal advisors</b> for the due diligence on the existing debt contracts (3) Make <b>substantial progress on the consultative phase</b> of restructuring with creditors (by first review).	
Jamaica	SBA	2010	Domestic, pre-emptive	Prior Action	Finalization	<b>Launch and complete debt exchange operation</b> that, in comparison to the existing securities, achieves an estimated saving of over 3 percent of GDP in FY2010/11 and a reduction in the amount of debt maturing during 2010-2012 by at least two thirds	
Seychelles	SBA	2008	External, post-default	None	n/a		MEFP reported recent hiring of advisors and intention to develop a comprehensive restructuring strategy, but no timeline was specified
Dominican Republic	SBA	2005	External, post-default	Prior Action	Intermediate	(1) <b>Completion of consultative phase of rescheduling/restructuring</b> with private sector creditors (bondholders and commercial banks) (2) <b>Initiation of restructuring negotiations</b> with private external creditors on debt still in arrears, consistent with Fund's LIA policy	MEFP also reported the intention to launch a bond exchange offer in the first quarter of 2015 and complete commercial bank rescheduling by April
Argentina	SBA (EA)	2003(Dec)	External, post-default	Structural Benchmark	Intermediate	<b>Announce the basic features of a restructuring offer</b> in conjunction with the IMF/World Bank Annual Meetings in September, 2003. This announcement will clarify the scope of debt to be restructured, the treatment of initial claims and past due interest, and the general terms of the new debt instruments to be issued in the exchange.	
Argentina	SBA (EA)	2003(Jan)	External, post-default	Structural Benchmark	Intermediate	<b>Appointment of an external advisor</b> on public debt restructuring	MEFP also committed to preparatory steps, including preparing database on creditor structure and dialogue with creditors on procedural aspects

Country	IMF Program	Year	Restructuring Type	Form	Finalization/ Intermediate	Specific language	Notes
Uruguay	SBA (EA)	2003	External, pre-emptive	Prior Action	Intermediate	<b>Obtain and present to staff evidence of adequate financing assurances</b> to meet financing needs for the 2003 program	Supplementary LOI outlined broad features of the proposed exchange and specified intention to launch by April and conclude by early May
Argentina	SBA (EA)	2001	External and domestic, pre-emptive	None	n/a		Both 3rd and 4th Reviews mentioned authorities' intention to undertake voluntary reprofiling operations, but these were treated as an upside risk
Pakistan	EFF-ESAF	1999	External, pre-emptive	Prior Action	Intermediate	<b>Initiation of negotiations with commercial creditors</b> on debt restructuring.	
Russia	SBA	1999	External, post-default	None	n/a		MEFP reported that the government had been in close contact with creditors and intended to undertake negotiations in a cooperative manner
Russia	EFF	1998	External and domestic, pre-emptive	None	n/a		A debt exchange for domestic instruments (GKOs) had already been launched, with results to be announced on the day of the board meeting, but the program assumed modest take up
Ukraine	EFF	1998	External and domestic, pre-emptive	None	n/a		Supplemental LOI mentioned active discussions with external commercial banks, imminent offer for voluntary rescheduling of non-resident held T-bills, and an already initiated voluntary rescheduling of resident-held debt

## Appendix III. Internal Creditor Processes and Assessing Credible Official Creditor Process

**1. To help illustrate the concept of “credible official creditor process”, and its relation to a “specific and credible assurance” staff consider three creditors’ internal processes.** The three creditors are all members of the Paris Club (PC), but the assessment looks only at their internal processes, abstracting from their relationship to the PC, in order to illustrate how the concepts might be applied more generally.

### PC Creditor A

**2. Official bilateral credit is extended through different entities.** Export credit support is done through a private company, under a contract agreed with the government. The entire statutory cumulative exposure limit of the Export Credit Agency (ECA) is provisioned on the federal budget as a contingent liability, and therefore, in case of default, no additional budgetary request to the legislature is needed to cover the losses. Concessional lending is done through the government-owned development bank. government guarantees are activated if losses cannot be absorbed by a general reserves fund.

**3. In restructuring cases, the Ministry of Finance (MoF) typically receives a request and initiates the procedure** in accordance with the rules outlined in the national budgetary law. The budget law enables the government to pursue debt restructurings based on multilateral agreements, and no additional legislative procedure is required. Moreover, export companies have already agreed to participate in debt restructurings upon signing contracts with the ECA. Once the process is launched, internal governmental coordination takes place among the unit responsible for debt restructurings, the budget department, and related governmental ministries. Debt information is obtained from the ECA and the concessional lender and is made available to help with any multilateral debt reconciliation exercise. The MoF briefs the lenders on their expected contribution in terms of debt relief and/or restructuring based on discussions with other creditors and information sourced from the IMF. The decision-making authority rests with the MoF.

### PC Creditor B

**4. Official bilateral credit is extended through several agencies.** Each of these agencies has an authorizing statute that establishes its exposure limits, and they share a risk assessment model to inform their lending and activities. Interagency information exchanges take place routinely. Both loans and guarantees are booked at their net present value incorporating information about loan terms and expected borrower behavior. This is a de facto form of provisioning, and if the government decides to provide debt relief outside that which was envisaged within the risk criteria of the model, additional authority and funds are often required from the legislature before any debt relief is executed.

**5. In restructuring cases, the Ministries of Finance and Foreign Affairs (MoF/MFA) are responsible for interagency coordination.** A request is typically received by one or both Ministries, which initiates procedures by coordinating the terms of the treatment, potential repayment schedules, and potential costs among all relevant parties, including budget authorities. Once the procedure is launched, the MoF/MFA obtains debt information from the lenders and agencies and assists with any debt reconciliation exercise needed with the borrower. The ministries coordinate with other creditors, the IMF, and the World Bank, and then brief lenders on their expected contribution to the debt relief. Once all domestic parties agree to the terms, assess any costs, and receive any necessary funding, the Ministries work with the borrowing country on a formal bilateral agreement, which must be signed by the MFA and borrowing country's MoF. Only then can any debt restructuring, or relief enter into force.

### PC Creditor C

**6. Official bilateral credit is extended through three entities.** Export credit and overseas investment support is done through an agency supervised by the MoF, and an agency supervised by the Ministry of Economy (MoE). A third agency provides concessional loans and grants for development finance and is supervised by the MFA. Annual operational budgets for these three agencies are approved by the legislature. National aggregate exposures of each agency are monitored by the MoF, and each institution has its own provisioning policy. Losses associated with a restructuring are in principle covered by this provisioning, and there have been no cases where special compensation was made exclusively for an agency in the aftermath of a restructuring. If budget support were to be requested to cover losses beyond what is provisioned, it would require legislative approval.

**7. In restructuring cases, a request is received by either the MoF or the MFA.** Debt information is obtained and made available for any debt reconciliation exercise, and lenders are briefed on the expected contribution in terms of debt relief (based on discussions with other creditors and information sourced from the IMF). The MoF, MFA and MoE and their agencies closely collaborate not only during restructurings but also during regular times and develop a unified strategic position on the debt restructuring request. That national position is then represented by the MoF, and the legally-binding bilateral agreement is signed after Cabinet approval.

### Assessment

**8.** The three creditors have an extensive track record of debt relief, and systems set up to support it (including budgetary provisions and concerning information sharing). The assessments would proceed as follows:

- **In a specific and credible assurances approach,** staff would seek assurances from the MoF in all three creditors, setting out their willingness to restructure in line with program parameters, with a view to finalizing an agreement before the first review under the Fund supported program. These would most likely be provided by a written statement by the MoF, and likely involve the country's lawyers, with possible negotiations at how this would be phrased (to

ensure consistency with the creditors' domestic legal framework). This approach would need to wait until the end of the processes in Creditors A through C, as the provider of the assurance would have to respect the domestic legal processes before providing such a commitment.

- Under a policy that relies on determining that there is a **“credible official creditor process,”** staff and management have the ability to consider the totality of circumstances and make a judgment, giving more leeway than the provider of SCA has. In view of the three countries' track records, this could come as early as: for Creditor A the point at which the MoF briefs the lenders on their expected contributions towards debt relief; for Creditor B, the point at which internal agreement to provide debt relief has been reached; and for Creditor C once the unified strategic position is developed by the three relevant ministries (i.e., given the need for consensus). Note that for creditor B and C the point could come later, to the extent that legislative action is required and there is no track record on this. In all three cases, before determining that there is a “credible official creditor process”, Management and staff (and ultimately the Board) would need to be satisfied that: (i) the process was proceeding on the basis of program parameters (noting that staff would be in a position to share the necessary information, with the permission of the debtor); and (ii) the key point has indeed been reached (and to this end, a simple communication could suffice, given the countries' track records). There would be no need for the more complex communication involved with SCA (nor any negotiations on the language thereof).

## Appendix IV. Approval in Principle

### History and Purpose of Approval in Principle

1. During the 1980s, the Executive Board used the Approval in Principle procedure as a mechanism to catalyze agreement between Fund members and their creditors (both official and private). It was used in circumstances in which understandings on policies underlying a Fund supported program had been reached between the Fund and the member, but where no agreement had been reached with creditors on new financing or debt relief for the member. Absent such agreement on new financing or debt relief, the Fund was precluded from the outright approval of an arrangement for the member as the necessary financing assurances required for the Fund-supported program were not in place (since the financing or debt relief was designed to fill any residual financing gaps in the program).
2. Approval in Principle allowed for the Fund to approve, in principle, an arrangement for the member without the arrangement becoming effective immediately. The Approval in Principle of a Fund arrangement was based on the policy understandings reached, while allowing additional time for agreement to be reached between the member and its creditors in respect of financing or debt relief. Once this agreement was reached and, accordingly, the necessary financing assurances granted, the Executive Board would then decide to make the arrangement effective.
3. The Approval in Principle procedure was used 19 times between 1983 and 1988. Used for the first time in 1983 on an ad hoc basis, the procedure was used a further 7 times between 1983 and 1984.<sup>1</sup> In 1984, in response to a call from Executive Directors to provide clearer guidance on the circumstances in which Approval in Principle should be used, staff proposed and the Executive Board subsequently endorsed guidelines in respect of the application of the Approval in Principle procedure (the “1984 Guidelines”). After the adoption of the 1984 Guidelines, the procedure was used a further 11 times.<sup>2</sup>
4. The Approval in Principle procedure, over time, was no longer needed and the 1984 Guidelines have since lapsed. The Approval in Principle procedure was designed to address coordination issues relating to the necessity of a Fund arrangement as a precursor to extraordinary treatment at the Paris Club and to catalyze agreement with private creditors. Over time, due to a growing willingness of Paris Club creditors to give assurances on debt relief—including for extraordinary financing—before arrangement approval, this procedure was no longer needed. In addition, the need for an Approval in Principle approval was obviated by more informal interactions between Fund staff and the Paris Club, as well as the necessary financing assurances being granted by way of the anticipated Paris Club Agreed Minutes. With respect to private creditors, the procedure was no longer needed because of the willingness of the Fund to “lend into arrears” – i.e., to go forward even in the absence of an agreement (in these cases, the arrears provided the

<sup>1</sup>Sudan, Ecuador, Zaire, Madagascar, Sudan, Cote d’Ivoire, Jamaica, Zambia.

<sup>2</sup>Kenya, Somalia, Chile, Zaire, Republic of Congo, Mexico, Nigeria, Argentina, Code d’Ivoire, Yugoslavia, Brazil.

necessary financing under the arrangement).<sup>3</sup> Accordingly, the specific circumstances related to the 1984 Guidelines are no longer relevant and accordingly the 1984 Guidelines have lapsed.

### How the Approval in Principle Procedure Worked

5. The procedure for Approval in Principle involved a first decision by the Executive Board approving a Fund arrangement “in principle”. For uniformity of treatment reasons, it was recognized in 1984 that this decision could only be taken once there was complete understanding between the Fund and the member on policies, and the only issue preventing outright approval of an arrangement for the member lay outside of the member’s control with third parties, namely the need to secure appropriate financing assurances from sovereign bilateral or commercial creditors in the form of debt relief.

6. Once the necessary financing assurances had been obtained, a second decision of the Executive Board was required for the arrangement to become effective. Two important aspects should be noted: First, there was no automaticity in respect of the effectiveness of a Fund arrangement that had been approved in principle. Management informed the Executive Board that the necessary financing assurances had been obtained, and detailed such assurances, and proposed a decision to be adopted on a lapse-of-time (LOT) basis to make the arrangement effective.<sup>4</sup> Second, this second decision was sometimes required to be adopted by the Executive Board within a period specified at the time of the decision to approve in principle. The 1984 Guidelines called for this time period “normally” not to exceed 30 days,<sup>5</sup> but acknowledged that the period should reflect the member’s circumstances. Factors motivating a relatively brief period between approval in principle and effectiveness of the arrangement included (a) the need to ensure that the program reached understandings on between the Fund and the member did not become “stale”,<sup>6</sup> (b) the need to ensure that the program was indeed being implemented and that (c) a concern that an excessive delay before the arrangement became effective could distort the phasing under the arrangement (e.g., most purchases are available by the time the arrangement becomes effective).

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<sup>3</sup>In respect of the Paris Club, the key issue requiring the use of the Approval in Principle procedure involved extraordinary financing. For commercial creditors, as the 1980s-debt crisis evolved and as banks’ balance sheets improved, there was a marked increase in the amount of time taken by commercial banks to agree to a restructuring. As this amounted to a de facto veto over Fund financial support, the Fund adopted the lending into arrears (LIA) policy in 1989.

<sup>4</sup>While all 19 cases in which Approval in Principle was used in the 1980s initially envisaged that the second decision would be taken on an LOT basis, there were several cases where a formal Executive Board meeting was held in order for the arrangement to become effective or, in cases where the Approval in Principle had lapsed, for the arrangement to be approved outright once the necessary assurances were obtained.

<sup>5</sup>In practice, there are cases both before and after the adoption of the 1984 Guidelines in which no deadline was specified. There are also cases in which the deadline was extended, usually on a LOT basis. Finally, there were also several cases after the adoption of the Guidelines where a deadline of longer than 30-days was set.

<sup>6</sup>For instance, performance criteria (PC) (such as for external arrears) could be missed and would therefore require waivers of nonobservance, or quantitative PCs were not yet set for a particular test date in the future and thus could not be assessed.

## Recent Application of AIP

7. Approval in Principle was last used in 2017 to approve in principle the Stand-by Arrangement for Greece.<sup>7</sup> The decision to use AIP does not require the adoption of a general policy. Approval in Principle is a procedural device designed to ensure the consistent application without the need for a change of the Fund's substantive policies. Going forward, it may be used consistent with the 2017 statement of the Managing Director.<sup>8</sup>

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<sup>7</sup>IMF, 2017, [Greece: Request for Stand-by Arrangement](#).

<sup>8</sup>FO/DIS/17/107.

## Appendix V. Applications of the LIOA

**Table AV.1. Arrears to Official Bilateral Creditors—Application of the LIOA**

Debtor	Facility, Approval	non-OSI	Rep. PC agreement	OSI	Three criteria	Emergency Financing
				Consent		
Afghanistan	ECF, 2016		x			
Afghanistan	ECF, 2020		x			
Argentina	SBA, 2018					
Argentina	EFF, 2022	x				
Barbados	EFF, 2018			x		
Burkina Faso	RCF, 2023			x		
Burkina Faso	ECF, 2016		x			
Central African Republic	ECF, 2017	x		x	x	
Central African Republic	ECF, 2019			x	x	
Central African Republic	ECF, 2023			x		
Chad	ECF 2017	x				
Chad	RCF, 2020	x				
Chad	ECF, 2020		x			
Comoros	RCF, 2020	x				
Rep. Of Congo	ECF, 2022		x	x		
Dem. Rep. Of Congo	ECF, 2019		x	x		
Djibouti	RCF, 2020					x
Ethiopia	EFF/ECF, 2019		x			
Gabon	EFF, 2017	x				
Gabon	RFI, 2020	x				
Gabon	EFF, 2021	x				
The Gambia	RCF, 2017			x		
The Gambia	ECF, 2020				x	
Ghana	ECF, 2023		x			
Grenada	ECF, 2016		x	x		
Grenada	RCF, 2020			x	x	
Guinea	ECF, 2017		x			
Guinea	ECF, 2016	x				
Guinea-Bissau	ECF, 2016			x		
Guinea-Bissau	RCF, 2021	x		x		
Guinea-Bissau	ECF, 2023			x		
Iraq	SBA, 2016		x			
Jamaica	EFF, 2016		x			
Jordan	EFF, 2016		x			
Monqolia	EFF, 2017			x		
Mozambique	RCF, 2019		x			
Mozambique	RCF, 2020	x				
Mozambique	ECF, 2022		x	x		
Sao Tome and Principe	ECF, 2015	x	x			
Sao Tome and Principe	ECF, 2019	x	x			
Sao Tome and Principe	RCF, 2020	x	x			
Serbia	SBA, 2016		x			
Somalia	EFF/ECF, 2020		x			
Sri Lanka	EFF, 2023			x		
Suriname	SBA, 2016	x				
Suriname	EFF, 2021			x		
Ukraine	EFF, 2016				x	
Ukraine	SBA, 2019				x	
Ukraine	SBA, 2020				x	
Zambia	ECF, 2022		x			

## Appendix VI. Document Risk Self-Assessment (DRSA)

Table AVI.1. Document Risk Self-Assessment (DRSA)			
	Rank	Risk Name	Risk Description
Top Risks to the Fund <b>WITHOUT</b> this policy proposal or strategy paper in place	#1	Reputational credibility risk	Inability to support members in need, including in emergencies, and inability to work effectively with all creditors.
	#2	Reputational objectivity risk	Reputational risk that the Fund lacks uniformity of treatment in lending to its membership and in its treatment of creditors, for example by an inability to adapt Fund requirements to different creditor processes.
	#3	Financial credit risk	Credit risk from non-engagement. The member's capacity to repay the Fund could erode at the same time as the Fund is prevented or delayed in engaging with the member and help resolve its medium-term viability challenge.
	#4	Business member engagement risk	Inaction or excessive delays could lead to spillovers to the Fund's wider membership, with other countries delaying their efforts to address unsustainable debt burdens, contributing towards a building debt crisis, with eventual contagion.
Top Risks to the Fund <b>WITH</b> this policy proposal or strategy paper in place	#1	Reputational objectivity risk	Reputational risk if proposals do not lead to faster restructurings. The Fund could be seen as having granted unwarranted accommodation official bilateral creditors and seen as being the source of delay for not making unsupported assessments of COCP.
	#2	Financial credit risk	Credit risk from mistaken judgments on COCP or use of LIOA strand 4. In a standard normal access case when the creditor has no intention to commit, the Fund would have financial exposures--alongside creditors unwilling to commit to restructuring--to a debtor in debt distress which will face delays in resolving its balance of payments problem.
	#3	Financial credit risk	Credit risk from a debtor's pursuit of EF standing in the way of a UCT program. If the debtor and bilateral official creditors do not set a course towards adequate debt relief, then the Fund would have financial exposures to a debtor in debt distress which will then further complicate its balance of payments problem.
	#4	Financial adequacy of resources risk	Financial risk on adequacy and liquidity of lending resources when proposals lead to broader use of emergency financing by members undergoing debt restructurings when they collectively face exceptional circumstances.



April 5, 2024

## POLICY REFORM PROPOSALS TO PROMOTE THE FUND'S CAPACITY TO SUPPORT COUNTRIES UNDERTAKING DEBT RESTRUCTURING—SUPPLEMENTARY INFORMATION

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## INTRODUCTION

1. For illustrative purposes, if all of staff's proposals contained in the main paper (**Policy Reform Proposals to Promote the Fund's Capacity to Support Countries Undertaking Debt Restructurings**) are endorsed by the Executive Board, staff attaches to this supplement a clean (**Annex 1**) and redlined (**Annex 2**) version of the consolidated draft Executive Board understandings of the Fund's policies on arrears and financing assurances in debt restructuring cases. The redlined version shows the differences of the proposals versus current Fund policies. The benefit for Executive Directors of this approach is that Annexes 1 and 2 consolidate current Fund policies with proposed revisions to enable a comprehensive view of the amended Fund's sovereign arrears policies. In line with the approach taken during the 2022 Review of the Fund's Sovereign Arrears Policies and Perimeter, after the Executive Board meeting and dependent on the outcome of the Executive Board considerations of staff's proposals, staff will revise Annexes 1 and 2 and reissue them to the Executive Board prior to publication.

## **Annex I. Consolidated Draft Executive Board Understanding of the Fund’s Policies with Respect to Arrears and Financing Assurances in Debt Restructuring Cases**

### **Lending Into Arrears (LIA) Policy**

1. Directors concurred that the Fund’s policy on lending into arrears to private creditors continues to provide a useful tool enabling the Fund to support a member’s adjustment efforts before the member has reached agreement with its private creditors on a debt restructuring. Specifically, Directors agreed that Fund lending into sovereign arrears to private creditors should continue to be on a case-by-case basis and only where:
  - (i) prompt Fund support is considered essential for the successful implementation of the member’s adjustment program; and
  - (ii) the member is pursuing appropriate policies and is making a good faith effort to reach a collaborative agreement with its creditors.
  
2. Directors also agreed that Fund lending into non-sovereign arrears stemming from the imposition of exchange controls should continue to be on a case-by-case basis and only where:
  - (i) prompt Fund support is considered essential for the successful implementation of the member’s adjustment program; and
  - (ii) the member is pursuing appropriate policies, the member is making a good faith effort to facilitate a collaborative agreement between private debtors and their creditors, and a good prospect exists for the removal of exchange controls.
  
3. With respect to lending into sovereign arrears to private creditors, Directors agreed that greater clarity about the good faith dialogue between a debtor and its creditors during the restructuring process and enhanced debt transparency could help provide better guidance about the application of the Fund’s LIA policy and, more generally, promote a better framework for the engagement of debtors and creditors in the restructuring of sovereign debt. Greater clarity concerning the framework for possible debt restructuring would strengthen the capacity of investors to assess recovery values under alternative scenarios, thereby facilitating the pricing of risk and improving the functioning of the capital markets. At the same time, however, Directors stressed the need for continued flexibility in applying the “good faith” criterion to accommodate the characteristics of each specific case to avoid putting debtors at a disadvantage in the negotiations with creditors; and to avoid prolonged negotiations that could hamper the ability of the Fund to provide timely assistance. Indeed, any clarification of the “good faith” criterion should serve primarily to support the difficult judgments that will continue to have to be made in each case, and should be made operational in a manner that does not impair market discipline.

4. Directors considered that the following principles would strike an appropriate balance between clarity and flexibility in guiding the dialogue between debtors and their private external creditors.

*First*, when a member has reached a judgment that a restructuring of its debt is necessary, it should engage in an early dialogue with its creditors, which should continue until the restructuring is complete.

*Second*, the member should share relevant information with all creditors on a timely basis, which would generally be aligned with what the member would be required to share under the Debt Limits Policy and normally include:

- an explanation of the economic problems and financial circumstances that justify a debt restructuring;
- a briefing on the broad outlines of a viable economic program to address the underlying problems and its implications on the broad financial parameters shaping the envelope of resources available for restructured claims; and
- the provision of a comprehensive picture of the outstanding debt stock and its terms, and the proposed treatment of all claims on the sovereign, including those of official bilateral creditors; the perimeter of claims subject to the envisaged debt restructuring; and the elaboration of the basis on which the debt restructuring would restore medium-term debt sustainability, bearing in mind that not all categories of claims may need to be restructured.

*Third*, the member should provide creditors with an early opportunity to give input on the design of restructuring strategies and the design of individual instruments.

*Fourth*, any terms offered to the creditors by the member should be consistent with the parameters of the Fund-supported program.

5. Although, as a general premise, the form of the dialogue would continue to be left to the debtor and its creditors, under this approach a member in arrears would be expected to initiate a dialogue with its creditors consistent with the principles discussed above. In cases in which creditors have been able to form a representative committee on a timely basis, there would be an expectation that the member would enter into good faith negotiations with this committee, though the unique characteristics of each case would also be considered.

6. Directors stressed that, in going forward with the suggested approach, it would be crucial to strike the appropriate balance between the need to promote effective communication between a debtor and its creditors, and the need to retain flexibility to address the diversity of individual member circumstances.

7. Directors emphasized that in assessing whether the member is making good faith efforts to negotiate, judgments would continue to be required in a number of important areas. These include a consideration of the extent to which creditor committees are sufficiently representative, and whether a reasonable period has elapsed to allow for the formation of representative committees. In the absence of such creditor committees, the member would be expected to engage creditors through a less structured dialogue.

8. Directors viewed the considerations laid out in the staff paper as useful inputs for helping to make such judgments, which would need to be made flexibly. They also noted that to the extent that negotiations become stalled because creditors are requesting terms that are inconsistent with the adjustment and financing parameters that have been established under a Fund-supported program, the Fund should retain the flexibility to continue to support members notwithstanding the lack of progress in negotiations with creditors.

9. Directors recognized that there may be circumstances where, following a default, the debtor enters into good faith discussions with creditors prior to the approval of a Fund arrangement. In these circumstances, creditors are likely to express views as to the appropriate dimensions of the program's adjustment and financing parameters. While such input would be welcome, Directors emphasized that decisions on an adequate macroeconomic framework and the design of the financing plan or the adjustment program that could form the basis for the Fund's lending into arrears will remain in the sole purview of the Fund.

10. Directors recognized that there may be emergency situations, such as in the aftermath of a natural disaster, where the extraordinary demands on the affected government are such that there is insufficient time for the debtor to undertake good faith efforts to reach agreement with its creditors. When a judgment has been made that such exceptional circumstances exist, the Fund may provide financing under the Rapid Credit Facility (RCF) or the Rapid Financing Instrument (RFI) despite arrears owed to private creditors. However, it would be expected that the Fund's support provided to the debtor in such cases would help advance normalization of relations with private creditors and the resolution of arrears, so that the approval of any subsequent Fund arrangement for the member would again be subject to the LIA policy on lending into sovereign arrears to private creditors.

11. All purchases and disbursements made while a member has outstanding arrears to private creditors will continue to be subject to financing assurances reviews, which will provide an opportunity for the Fund to monitor relations between a debtor and its creditors, and for the Board to be kept informed about developments in this area at an early stage.

12. The policy outlined above supersedes all previous policies regarding lending into arrears to private creditors.

### **Codifying Existing LIA Practice into a Policy in Preemptive Restructuring Cases**

13. Directors agreed that the current practice in preemptive restructuring cases remains appropriate. To the extent that the Fund determines that a contribution from external private

creditors in the form of a debt restructuring will be needed to restore debt sustainability, the restructuring should ideally be undertaken before the approval of the Fund arrangement. However, there may be circumstances under which more flexibility is warranted, so that the conclusion of the debt operation is contemplated at a later date, normally, by the first review under the arrangement. In such cases, the Fund may provide financing only if it has adequate assurances that such a restructuring will be successful. Such assurances are obtained by a judgment that a credible process for restructuring is underway and will result in sufficient creditor participation to restore debt sustainability and close financing gaps within the macroeconomic parameters of the program, taking into account official sector commitments. This judgment will depend on member-specific circumstances, but relevant considerations to inform such judgment may include the engagement of legal and financial advisors by the member, the launching of consultations with creditors, and the design of the debt restructuring strategy, including the terms of the new instruments and use of inducements for creditor participation. Directors welcomed the recommendation to add an expectation that the member would be expected to share relevant information as defined under the LIA policy with all private creditors on a timely basis.

### **Lending Into Arrears to Official Bilateral Creditors (LIOA) Policy**

Directors broadly agreed that the Fund's non-toleration of arrears policy in non-(Official Sector Involvement) OSI cases and the policy on lending into sovereign arrears to official bilateral creditors in OSI cases, covering a three-strand approach, continues to be appropriate, but with adjustments to introduce a fourth strand in the LIOA policy as detailed below. Most Directors agreed that more experience is needed with the Common Framework (CF) and welcomed staff's plan to closely monitor the CF's evolution and revert to the Board on whether it emerges as a new representative standing forum.

14. The LIOA policy is as follows:

*Strand 1:* If an agreement is reached through the Paris Club that is adequately representative, the Fund would rely on its current practices—i.e., arrears would be considered eliminated (for purposes of the application of this policy) for both participating and non-participating creditors when financing assurances are received from the Paris Club in anticipation of an Agreed Minute. Should another representative standing forum emerge, the Fund would be open to engaging with such a forum. Directors agreed that Strand 1 should remain the central focus of this policy and should be used whenever it is or becomes available.

*Strand 2:* An official bilateral creditor may choose to consent to Fund financing notwithstanding arrears owed to it. In such cases, the Board would not need to make a judgment as to whether the three criteria in Strand 3 below are satisfied. The Fund would nevertheless continue to encourage the parties to come to an agreement to resolve arrears, since the regularization of arrears is an objective of any Fund-supported program and important for the functioning of the international financial system at large.

*Strand 3:* In circumstances where an adequately representative agreement has not been reached through the Paris Club, and creditor consent has not been received, the Fund would consider lending into arrears owed to an official bilateral creditor only in circumscribed circumstances where all the following criteria are satisfied:

- Prompt financial support from the Fund is considered essential, and the member is pursuing appropriate policies;
- The debtor is making good faith efforts to reach agreement with the creditor on a contribution consistent with the parameters of the Fund-supported program—i.e., that the absence of an agreement is due to the unwillingness of the creditor to provide such a contribution; and
- The decision to provide financing despite the arrears would not have an undue negative effect on the Fund’s ability to mobilize official financing packages in future cases.

In applying the above criteria, the Fund will need to exercise judgment based on case-specific circumstances. In exercising this judgment, the Board will be guided by the following considerations:

*First*, an agreement will be considered “adequately representative” when it provides a majority of the total financing contributions required from official bilateral creditors over the program period. “Contribution” here comprises, and is limited to, debt relief and new financing (e.g. loans, bond financing, guarantees, and grants).

*Second*, in assessing whether a debtor is acting in good faith, the Fund will consider, inter alia, whether the debtor has approached the creditor to which it owes arrears either bilaterally or through a relevant grouping of official bilateral creditors, recognizing that the latter may take several forms, including ad hoc creditor committees; has offered to engage in substantive dialogue with the creditor and has sought a collaborative process with the creditor to reach agreement; has provided the creditor relevant information on a timely basis consistent with the Fund’s policy on confidentiality of information; and has offered the creditor terms that are consistent with the parameters of the Fund-supported program. If the debtor requested terms from an official bilateral creditor that would result in financing contributions that exceeded the requirements of the program it would generally not indicate good faith. Finally, an assessment of the second criterion would also take into consideration the extent to which a creditor is being asked to make a contribution that is disproportionate relative to other official bilateral creditors.

*Third*, in assessing whether the Fund’s decision to lend into arrears owed to an official bilateral creditor would have an undue negative effect on the Fund’s ability to mobilize official financing packages in future cases, the Fund will consider the signal that such a decision would send to official bilateral creditors as a group, given the specific circumstances of the

case. In particular, this criterion would normally not be satisfied where the creditor or group of creditors that has not reached agreement with the debtor accounts for an adequately representative share, i.e., a majority, of total financing contributions required from official bilateral creditors over the program period, as defined above. Separately, an assessment of whether the third criterion is satisfied would take into consideration the creditor's track record of providing contributions in past debt restructurings under Fund-supported programs, even if the creditor does not account for an adequately representative share of total financing contributions.

*Strand 4:* The Fund shall seek additional safeguards under this policy where an adequately representative agreement has not been reached through the Paris Club or the Common Framework involving the Paris Club, consent is not forthcoming within 4 weeks of being requested, *and* the three criteria under Strand 3 cannot be satisfied with respect to an official bilateral creditor. The approach would distinguish the Fund-supported programs with normal access from those with exceptional access under the GRA or the PRGT or high combined access under the GRA and PRGT.

- In the first case, the “standard safeguards approach” would apply (except as noted below). This would require a combination of program design elements—including the phasing of access under the arrangement (with an initial purchase or disbursement capped at low access), program conditionality to support the restructuring process where warranted under the Guidelines on Conditionality, and a debtor commitment to good faith efforts to establish additional safeguards for Fund lending.
- In the second case, the “enhanced safeguards approach” would apply, which requires the debtor commitment and conditionality under the standard safeguards approach, and in addition a direct commitment to the Fund by a sufficient set of creditors about their restructuring intentions. Where such a commitment is provided, arrears would be considered eliminated (for purposes of the application of this policy) for both participating and non-participating creditors. A “sufficient set” of creditors requires the participation of any representative standing creditor forum as well as any creditors with significant influence over the debtor. For this purpose, a creditor is considered to have significant influence over the debtor when it has the ability to extract repayment on more favorable terms, inconsistent with program parameters.

While the standard safeguards approach will normally be sufficient for normal access cases that fall into Strand 4, a shift to the enhanced safeguards approach would be warranted, based on an explicit signal that a creditor or creditor group to which the three criteria in Strand 3 cannot be satisfied either (1) is unwilling to restructure its or their claims in line with program parameters; or (2) views additional support by the Fund to the debtor's effort to coordinate with creditors to be essential.

*Emergency situations:* There may be emergency situations caused by significant exogenous shocks or natural disasters, where the extraordinary demands on the affected government are

such that there is insufficient time for the debtor to undertake good faith efforts to reach agreement with its creditors. When a judgment has been made that such exceptional circumstances exist, the Fund may provide financing under the Rapid Credit Facility (RCF) or the Rapid Financing Instrument (RFI) despite arrears owed to official bilateral creditors and without assessing whether the three criteria above have been satisfied or obtaining the creditor's consent. However, it would be expected that the Fund's support provided to the debtor in such cases would help advance normalization of relations with official bilateral creditors and the resolution of arrears, so that the approval of any subsequent Fund arrangement for the member would again be subject to all three criteria set out above. This assessment would be based on the debtor's commitment to make good faith efforts toward resolving the arrears and to conduct itself in a way to promote and encourage creditor coordination. Directors expected that this "exceptional circumstances" clause would generally not be satisfied for cases with long-standing arrears.

Directors concurred that new Fund-supported programs should continue to incorporate the assumption that old OSI-related claims would be restructured in line with the terms stipulated in the original Fund-supported program. Should new arrears arise due to the exercise of a comparability of treatment clause, such arrears shall be classified as non-OSI, and thus be subject to the Fund's non-tolerance of arrears policy, regardless of whether an additional debt treatment is required.

### **International Financial Institutions**

15. Directors agreed that application of the non-tolerance of arrears policy with respect to multilaterals has worked well, but the policy needs to be updated to clarify how the policy applies to new International Financial Institutions (IFIs) and to ensure that the special treatment multilateral creditors receive under the Fund's arrears policy is not diluted. IFIs are defined as international financial institutions with at least two sovereign members (and no non-sovereign member). While many Directors expressed a preference for staff's original proposal on this issue (in [Review of the Fund's Sovereign Arrears Policies and Perimeter](#)), which would reduce scope for judgement in this area and provide for more clarity, a number of Directors could not support staff's original proposal. In the end, most Directors went along with the alternative approach set out in Supplement 1 in light of staff's expectation that implementation of the approach described in Supplement 1 would not fundamentally differ from that in the original proposal. Therefore, Directors endorsed the following:

*First*, Fund financing in the face of arrears to the World Bank Group should continue to require an Agreed Plan between the debtor and the World Bank to clear the arrears over a defined period. Fund financing in the face of arrears to any other IFI should continue to require that a Credible Plan be in place in cases where a contribution from the official sector is not required in order to restore debt sustainability (non-OSI cases). In this context, a Credible Plan is a plan that is credible to the Fund, and the creditor's concurrence is not required.

*Second*, in cases where a contribution from the official sector is required in order to restore debt sustainability (OSI cases):

- Where the member is in arrears to an IFI, the Fund should judge whether a Credible Plan to resolve such arrears is required as a condition for lending. Factors informing the Fund’s judgment in this regard will include: (i) global, rather than regional, membership of the institution; (ii) whether the institution is a regional financing arrangement or a reserve currency union central bank that forms part of the global financial safety net; (iii) the Paris Club’s treatment of the institution, (iv) participation of the institution in the Heavily Indebted Poor Countries (HIPC) Initiative, and (v) whether the institution is being excluded from the scope of debt restructuring by official bilateral creditors through a creditor committee based on a representative standing forum recognized under the LIOA policy in the case at hand.
- When arrears are owed to an IFI that does not fall under the previous bullet above, Directors agreed that the LIOA policy should be expanded to apply to these cases *mutatis mutandis*. In these cases, the Fund policy will also provide for the flexibility in extraordinary circumstances for emergency financing cases consistent with the LIOA policy.

In the latter cases, the Fund would consider lending into arrears owed to an IFI creditor only in circumscribed circumstances where all the following criteria are satisfied:

- Prompt financial support from the Fund is considered essential, and the member is pursuing appropriate policies;
- The debtor is making good faith efforts to reach agreement with the IFI creditor on a contribution consistent with the parameters of the Fund-supported program—i.e., that the absence of an agreement is due to the unwillingness of the creditor to provide such a contribution; and
- The decision to provide financing despite the arrears would not have an undue negative effect on the Fund’s ability to mobilize official financing packages in future cases.

16. In assessing whether a debtor is acting in good faith, the Fund will consider, *inter alia*, whether the debtor has approached the IFI creditor to which it owes arrears bilaterally; has offered to engage in substantive dialogue with the IFI creditor and has sought a collaborative process with the creditor to reach agreement; has provided the creditor relevant information on a timely basis consistent with the Fund’s policy on confidentiality of information; and has offered the creditor terms that are consistent with the parameters of the Fund-supported program. If the debtor requested terms from an IFI creditor that would result in financing contributions that exceeded the requirements of the program it would generally not indicate good faith.

17. In assessing whether the Fund’s decision to lend into arrears owed to an IFI creditor would have an undue negative effect on the Fund’s ability to mobilize official financing packages in future cases, the Fund will consider the signal that such a decision would send to IFI creditors, or to official creditors more generally, as a group, given the specific circumstances of the case.

18. An IFI creditor may choose to consent to Fund financing notwithstanding arrears owed to it. Such consent could be conveyed to the Fund either through an Executive Director designated by the IFI or an authorized executive of the IFI to the Managing Director. In such cases, the Executive Board would not need to make a judgment as to whether the three criteria above are satisfied. The Fund would nevertheless continue to encourage the parties to come to an agreement during the program, since the regularization of arrears is an objective of any Fund-supported program and important for the functioning of the international financial system at large.

19. So long as arrears to IFI creditors remain outstanding, purchases or disbursements will be subject to a financing assurances review where the Executive Board will verify that all three criteria are satisfied and the policy continues to be met for the further use of the Fund's resources in the member's circumstances.

### **Financing Assurances Reviews**

20. Directors also supported strengthening financing assurances reviews under the LIOA and LIA policies while external arrears remain unresolved, and introducing financing assurances reviews both in cases where arrears are deemed away under Strands 1 and 4 under the LIOA policy and in preemptive restructuring cases needed to restore debt sustainability involving official bilateral creditors until the needed restructuring is complete. Financing assurances reviews would continue to provide the Fund with the opportunity to assess continued compliance with the applicable arrears and financing assurances policies, whether the member's adjustment efforts are undermined by developments in debtor and creditor relations, and whether, in light of progress, the debt situation does not undermine the restoration of the member's medium-term external viability and its capacity to repay the Fund.

21. Directors agreed that in cases of unresolved external sovereign arrears subject to a debt restructuring, arrears deemed away under Strands 1 and 4 under the LIOA policy, or where a preemptive restructuring needed to restore debt sustainability is being undertaken that involves official bilateral creditors, requests for new Fund financing should lay out the expected steps and schedule for the restructuring process in an indicative way. Subsequent reviews should detail progress against that schedule taking into account all developments to determine whether the restructuring remains on track to ensure that overall program objectives are met. Directors further supported the proposal that financing assurances reviews should more explicitly assess whether the Fund still has appropriate safeguards to proceed with the financing, or needs to introduce additional standard or enhanced safeguards as warranted.

## Form of Financing Assurances

22. For restructuring cases where financing assurances need to be obtained from official bilateral creditors—namely, preemptive cases and Strand 1 and 4 of the LIOA policy—Directors agreed that such assurances could be obtained through the Fund’s assessment that a “credible official creditor process” (COCP) is underway. Directors stressed that each creditor would need to establish a track record on which the Fund could base its understanding of the process, key decisionmakers involved, and the expected timeframe for the completion of the debt restructuring, such that an assessment could be made that the key stage had been reached that would provide the Fund with the necessary assurances. Directors noted that, in the absence of sufficient information or a track record to make such an assessment, required financing assurances could continue to be satisfied by specific and credible assurances on debt relief/financing. Directors endorsed the proposal that, in pre-emptive cases, financing assurances would only be sought from a “sufficient set” of creditors, as defined under the enhanced safeguards approach under Strand 4 of the LIOA policy. Directors agreed that the policy for pre-emptive restructuring cases for private creditors remains unchanged.

## Perimeter

23. For the purpose of determining the application of the Fund’s arrears, financing assurances and debt sustainability policies, Directors broadly agreed with the approach proposed by staff.

24. Specifically, Direct Bilateral Claims will continue to be defined as those claims that are (a) held by a government, or an agency acting on behalf of a government; and (b) originate from an underlying transaction where the creditor government, or an agency acting on behalf of the government, provided or guaranteed financing to the debtor member.

25. In operationalizing this definition, Directors supported using the creditor member’s budgetary process to determine which entities form part of the creditor government. For entities that fall outside the government, a case-by-case analysis, taking into account the totality of the circumstances, would continue to be required to determine whether the entity is “acting on behalf of the government.” Directors recognized that secondary market purchases of claims by official bilateral creditors would not qualify as Direct Bilateral Claims, as they would not directly extend financing to the debtor member.

26. Directors endorsed two amendments to the classification of official claims: First, to the extent that the IFI purchases securities in the secondary market as part of the global financial safety net, such claims can be treated as claims subject to the Fund’s arrears policies as applicable to IFIs; however, the Fund would rely on the IFI’s own representation in this regard. Second, any Direct Bilateral Claims or claims held by IFIs that are contractually part of a pooled voting mechanism with private creditors shall be subject to the LIA policy.

## **Agreement in Principle**

27. Directors recognized the continued utility of the Agreement in Principle (AIP) as an optional procedural device to bridge engagement gaps when agreement on policies has been reached with the member but financing assurances to restore debt sustainability have not been received. They agreed that a few clarifications to the AIP are warranted in such cases. A decision to approve an arrangement in principle shall specify the date by which the approval would lapse, which would normally be no later than 4 months after approval. A new AIP shall only be permitted once and would normally be subject to a limit of an additional 4 months. The Fund would only approve a new AIP if the financing assurances restoring debt sustainability are likely to be delivered, and that the member's economic program is being implemented as agreed and remains on track. Once the financing assurances have been obtained, a second decision of the Executive Board is required to make the arrangement effective, which is normally adopted on a Lapse of Time basis. Directors stressed that, in all cases, staff should aim to bring a UCT-quality program forward for Executive Board consideration as fast as possible.

## **Effectiveness**

28. The above amendments and new policies will enter into effect immediately and will apply to all future purchases and disbursements (including under existing arrangements), where the relevant policies apply.

## **Reviews of the Arrears Policies**

29. Directors agreed that the Fund's arrears policies should be reviewed on an as needed basis.

## Annex II. Comparison of Draft Executive Board Understanding Against Current Policies

### Introduction

~~1. Directors welcomed the comprehensive review of the Fund's policy on lending into arrears to private creditors, the Fund's policy on lending into sovereign arrears to official bilateral creditors, and the Fund's non-tolerance of sovereign arrears policy to official bilateral and multilateral creditors.~~

~~2. Directors agreed that overall, the Fund's arrears policies have worked well in enabling the Fund to proceed with providing financing in cases of arrears. At the same time, they noted that practice in sovereign debt restructuring and the creditor landscape have evolved over the last 20 years and certain updates are in order.~~

### Lending Into Arrears (LIA) Policy

1. Directors concurred that the Fund's policy on lending into arrears to private creditors continues to provide a useful tool enabling the Fund to support a member's adjustment efforts before the member has reached agreement with its private creditors on a debt restructuring. Specifically, Directors agreed that Fund lending into sovereign arrears to private creditors should continue to be on a case-by-case basis and only where:

- (i) prompt Fund support is considered essential for the successful implementation of the member's adjustment program; and
- (ii) the member is pursuing appropriate policies and is making a good faith effort to reach a collaborative agreement with its creditors.

2. Directors also agreed that Fund lending into non-sovereign arrears stemming from the imposition of exchange controls should continue to be on a case-by-case basis and only where:

- (i) prompt Fund support is considered essential for the successful implementation of the member's adjustment program; and
- (ii) the member is pursuing appropriate policies, the member is making a good faith effort to facilitate a collaborative agreement between private debtors and their creditors, and a good prospect exists for the removal of exchange controls.

3. With respect to lending into sovereign arrears to private creditors, Directors agreed that greater clarity about the good faith dialogue between a debtor and its creditors during the restructuring process and enhanced debt transparency could help provide better guidance about the application of the Fund's LIA policy and, more generally, promote a better framework for the engagement of debtors and creditors in the restructuring of sovereign debt. Greater clarity

concerning the framework for possible debt restructuring would strengthen the capacity of investors to assess recovery values under alternative scenarios, thereby facilitating the pricing of risk and improving the functioning of the capital markets. At the same time, however, Directors stressed the need for continued flexibility in applying the “good faith” criterion to accommodate the characteristics of each specific case to avoid putting debtors at a disadvantage in the negotiations with creditors; and to avoid prolonged negotiations that could hamper the ability of the Fund to provide timely assistance. Indeed, any clarification of the “good faith” criterion should serve primarily to support the difficult judgments that will continue to have to be made in each case, and should be made operational in a manner that does not impair market discipline.

4. Directors considered that the following principles would strike an appropriate balance between clarity and flexibility in guiding the dialogue between debtors and their private external creditors.

*First*, when a member has reached a judgment that a restructuring of its debt is necessary, it should engage in an early dialogue with its creditors, which should continue until the restructuring is complete.

*Second*, the member should share relevant information with all creditors on a timely basis, which would generally be aligned with what the member would be required to share under the Debt Limits Policy and normally include:

- an explanation of the economic problems and financial circumstances that justify a debt restructuring;
- a briefing on the broad outlines of a viable economic program to address the underlying problems and its implications on the broad financial parameters shaping the envelope of resources available for restructured claims; and
- the provision of a comprehensive picture of the outstanding debt stock and its terms, and the proposed treatment of all claims on the sovereign, including those of official bilateral creditors; the perimeter of claims subject to the envisaged debt restructuring; and the elaboration of the basis on which the debt restructuring would restore medium-term debt sustainability, bearing in mind that not all categories of claims may need to be restructured.

*Third*, the member should provide creditors with an early opportunity to give input on the design of restructuring strategies and the design of individual instruments.

*Fourth*, any terms offered to the creditors by the member should be consistent with the parameters of the Fund-supported program.

5. Although, as a general premise, the form of the dialogue would continue to be left to the debtor and its creditors, under this approach a member in arrears would be expected to initiate a dialogue with its creditors consistent with the principles discussed above. In cases in which creditors

have been able to form a representative committee on a timely basis, there would be an expectation that the member would enter into good faith negotiations with this committee, though the unique characteristics of each case would also be considered.

6. Directors stressed that, in going forward with the suggested approach, it would be crucial to strike the appropriate balance between the need to promote effective communication between a debtor and its creditors, and the need to retain flexibility to address the diversity of individual member circumstances.

7. Directors emphasized that in assessing whether the member is making good faith efforts to negotiate, judgments would continue to be required in a number of important areas. These include a consideration of the extent to which creditor committees are sufficiently representative, and whether a reasonable period has elapsed to allow for the formation of representative committees. In the absence of such creditor committees, the member would be expected to engage creditors through a less structured dialogue.

8. Directors viewed the considerations laid out in the staff paper as useful inputs for helping to make such judgments, which would need to be made flexibly. They also noted that to the extent that negotiations become stalled because creditors are requesting terms that are inconsistent with the adjustment and financing parameters that have been established under a Fund-supported program, the Fund should retain the flexibility to continue to support members notwithstanding the lack of progress in negotiations with creditors.

9. Directors recognized that there may be circumstances where, following a default, the debtor enters into good faith discussions with creditors prior to the approval of a Fund arrangement. In these circumstances, creditors are likely to express views as to the appropriate dimensions of the program's adjustment and financing parameters. While such input would be welcome, Directors emphasized that decisions on an adequate macroeconomic framework and the design of the financing plan or the adjustment program that could form the basis for the Fund's lending into arrears will remain in the sole purview of the Fund.

10. Directors recognized that there may be emergency situations, such as in the aftermath of a natural disaster, where the extraordinary demands on the affected government are such that there is insufficient time for the debtor to undertake good faith efforts to reach agreement with its creditors. When a judgment has been made that such exceptional circumstances exist, the Fund may provide financing under the Rapid Credit Facility (RCF) or the Rapid Financing Instrument (RFI) despite arrears owed to private creditors. However, it would be expected that the Fund's support provided to the debtor in such cases would help advance normalization of relations with private creditors and the resolution of arrears, so that the approval of any subsequent Fund arrangement for the member would again be subject to the LIA policy on lending into sovereign arrears to private creditors.

11. All purchases and disbursements made while a member has outstanding arrears to private creditors will continue to be subject to financing [assurances](#) reviews, which will provide an

opportunity for the Fund to monitor relations between a debtor and its creditors, and for the Board to be kept informed about developments in this area at an early stage.

12. The policy outlined above supersedes all previous policies regarding lending into arrears to private creditors.

### **Codifying Existing Practice into a Policy in Preemptive Restructuring Cases**

13. Directors agreed that the current practice in preemptive restructuring cases remains appropriate. To the extent that the Fund determines that a contribution from external private creditors in the form of a debt restructuring will be needed to restore debt sustainability, the restructuring should ideally be undertaken before the approval of the Fund arrangement. However, there may be circumstances under which more flexibility is warranted, so that the conclusion of the debt operation is contemplated at a later date, normally, by the first review under the arrangement. In such cases, the Fund may provide financing only if it has adequate assurances that such a restructuring will be successful. Such assurances are obtained by a judgment that a credible process for restructuring is underway and will result in sufficient creditor participation to restore debt sustainability and close financing gaps within the macroeconomic parameters of the program, taking into account official sector commitments. This judgment will depend on member-specific circumstances, but relevant considerations to inform such judgment may include the engagement of legal and financial advisors by the member, the launching of consultations with creditors, and the design of the debt restructuring strategy, including the terms of the new instruments and use of inducements for creditor participation. Directors welcomed the recommendation to add an expectation that the member would be expected to share relevant information as defined under the LIA policy with all private creditors on a timely basis.

### **Lending Into Arrears to Official Bilateral Creditors (LIOA) Policy**

Directors broadly agreed that the Fund's non-toleration of arrears policy in non-(Official Sector Involvement) OSI cases and the policy on lending into sovereign arrears to official bilateral creditors in OSI cases, covering a three-strand approach, continues to be appropriate ~~and no amendments are needed, but with adjustments to introduce a fourth strand in the LIOA policy as detailed below.~~ Most Directors agreed that more experience is needed with the Common Framework (CF) and welcomed staff's plan to closely monitor the CF's evolution and revert to the Board on whether it emerges as a new representative standing forum.

14. The LIOA policy is as follows:

*Strand 1:* If an agreement is reached through the Paris Club that is adequately representative, the Fund would rely on its current practices—i.e., arrears would be considered eliminated (for purposes of the application of this policy) for both participating and non-participating creditors when financing assurances are received from the Paris Club in anticipation of an Agreed Minute. Should another representative standing forum emerge, the Fund would be

open to engaging with such a forum. Directors agreed that Strand 1 should remain the central focus of this policy and should be used whenever it is or becomes available.

Strand 2: An official bilateral creditor may choose to consent to Fund financing notwithstanding arrears owed to it. In such cases, the Board would not need to make a judgment as to whether the three criteria in Strand 3 below are satisfied. The Fund would nevertheless continue to encourage the parties to come to an agreement to resolve arrears, since the regularization of arrears is an objective of any Fund-supported program and important for the functioning of the international financial system at large.

Strand 3: In circumstances where an adequately representative agreement has not been reached through the Paris Club, and creditor consent has not been received, the Fund would consider lending into arrears owed to an official bilateral creditor only in circumscribed circumstances where all the following criteria are satisfied:

- Prompt financial support from the Fund is considered essential, and the member is pursuing appropriate policies;
- The debtor is making good faith efforts to reach agreement with the creditor on a contribution consistent with the parameters of the Fund-supported program—i.e., that the absence of an agreement is due to the unwillingness of the creditor to provide such a contribution; and
- The decision to provide financing despite the arrears would not have an undue negative effect on the Fund’s ability to mobilize official financing packages in future cases.

In applying the above criteria, the Fund will need to exercise judgment based on case-specific circumstances. In exercising this judgment, the Board will be guided by the following considerations:

*First*, an agreement will be considered “adequately representative” when it provides a majority of the total financing contributions required from official bilateral creditors over the program period. “Contribution” here comprises, and is limited to, debt relief and new financing (e.g. loans, bond financing, guarantees, and grants).

*Second*, in assessing whether a debtor is acting in good faith, the Fund will consider, inter alia, whether the debtor has approached the creditor to which it owes arrears either bilaterally or through a relevant grouping of official bilateral creditors, recognizing that the latter may take several forms, including ad hoc creditor committees; has offered to engage in substantive dialogue with the creditor and has sought a collaborative process with the creditor to reach agreement; has provided the creditor relevant information on a timely basis consistent with the Fund’s policy on confidentiality of information; and has offered the creditor terms that are consistent with the parameters of the Fund-supported program. If the debtor requested terms

from an official bilateral creditor that would result in financing contributions that exceeded the requirements of the program it would generally not indicate good faith. Finally, an assessment of the second criterion would also take into consideration the extent to which a creditor is being asked to make a contribution that is disproportionate relative to other official bilateral creditors.

*Third*, in assessing whether the Fund's decision to lend into arrears owed to an official bilateral creditor would have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases, the Fund will consider the signal that such a decision would send to official bilateral creditors as a group, given the specific circumstances of the case. In particular, this criterion would normally not be satisfied where the creditor or group of creditors that has not reached agreement with the debtor accounts for an adequately representative share, i.e., a majority, of total financing contributions required from official bilateral creditors over the program period, as defined above. Separately, an assessment of whether the third criterion is satisfied would take into consideration the creditor's track record of providing contributions in past debt restructurings under Fund-supported programs, even if the creditor does not account for an adequately representative share of total financing contributions.

~~An official bilateral creditor may choose to consent to Fund financing notwithstanding arrears owed to it. In such cases, the Board would not need to make a judgment as to whether the three criteria above are satisfied. The Fund would nevertheless continue to encourage the parties to come to an agreement during the program, since the regularization of arrears is an objective of any Fund-supported program and important for the functioning of the international financial system at large.~~

*Strand 4:* The Fund shall seek additional safeguards under this policy where an adequately representative agreement has not been reached through the Paris Club or the Common Framework involving the Paris Club, consent is not forthcoming within 4 weeks of being requested, and the three criteria under Strand 3 cannot be satisfied with respect to an official bilateral creditor. The approach would distinguish the Fund-supported programs with normal access from those with exceptional access under the GRA or the PRGT or high combined access under the GRA and PRGT.

- In the first case, the "standard safeguards approach" would apply (except as noted below). This would require a combination of program design elements—including the phasing of access under the arrangement (with an initial purchase or disbursement capped at low access), program conditionality to support the restructuring process where warranted under the Guidelines on Conditionality, and a debtor commitment to good faith efforts to establish additional safeguards for Fund lending.
- In the second case, the "enhanced safeguards approach" would apply, which requires the debtor commitment and conditionality under the standard safeguards approach, and in addition a direct commitment to the Fund by a sufficient set of creditors about their

restructuring intentions. Where such a commitment is provided, arrears would be considered eliminated (for purposes of the application of this policy) for both participating and non-participating creditors. A “sufficient set” of creditors requires the participation of any representative standing creditor forum as well as any creditors with significant influence over the debtor. For this purpose, a creditor is considered to have significant influence over the debtor when it has the ability to extract repayment on more favorable terms, inconsistent with program parameters.

While the standard safeguards approach will normally be sufficient for normal -access cases that fall into Strand 4, a shift to the enhanced safeguards approach would be warranted, based on an explicit signal that a creditor or creditor group to which the three criteria in Strand 3 cannot be satisfied either (1) is unwilling to restructure its or their claims in line with program parameters; or (2) views additional support by the Fund to the debtor’s effort to coordinate with creditors to be essential.

*Emergency situations:* There may be emergency situations, such as in the aftermath of a caused by significant exogenous shocks or natural disaster/disasters, where the extraordinary demands on the affected government are such that there is insufficient time for the debtor to undertake good faith efforts to reach agreement with its creditors. When a judgment has been made that such exceptional circumstances exist, the Fund may provide financing under the Rapid Credit Facility (RCF) or the Rapid Financing Instrument (RFI) despite arrears owed to official bilateral creditors and without assessing whether the three criteria above have been satisfied or obtaining the creditor’s consent. However, it would be expected that the Fund’s support provided to the debtor in such cases would help advance normalization of relations with official bilateral creditors and the resolution of arrears, so that the approval of any subsequent Fund arrangement for the member would again be subject to all three criteria set out above. This assessment would be based on the debtor’s commitment to make good faith efforts toward resolving the arrears and to conduct itself in a way to promote and encourage creditor coordination. Directors expected that this “exceptional circumstances” clause would generally not be satisfied for cases with long-standing arrears.

So long as unresolved arrears owed to official bilateral creditors are outstanding, every purchase or disbursement made available after the approval of the arrangement will be subject to a financing assurances review by the Board and verification that all three criteria are satisfied to determine whether this policy continues to be met for the further use of the Fund’s resources in the member’s circumstances.

Directors concurred that new Fund-supported programs should continue to incorporate the assumption that old OSI-related claims would be restructured in line with the terms stipulated in the original Fund-supported program. Should new arrears arise due to the exercise of a comparability of treatment clause, such arrears shall be classified as non-OSI, and thus be subject to the Fund’s non-tolerance of arrears policy, regardless of whether an additional debt treatment is required.

## International Financial Institutions

15. Directors agreed that application of the non-toleration of arrears policy with respect to multilaterals has worked well, but the policy needs to be updated to clarify how the policy applies to new International Financial Institutions (IFIs) and to ensure that the special treatment multilateral creditors receive under the Fund's arrears policy is not diluted. IFIs are defined as international financial institutions with at least two sovereign members (and no non-sovereign member). While many Directors expressed a preference for staff's original proposal on this issue (in [Review of the Fund's Sovereign Arrears Policies and Perimeter](#)), which would reduce scope for judgement in this area and provide for more clarity, a number of Directors could not support staff's original proposal. In the end, most Directors went along with the alternative approach set out in Supplement 1 in light of staff's expectation that implementation of the approach described in Supplement 1 would not fundamentally differ from that in the original proposal. Therefore, Directors endorsed the following:

*First*, Fund financing in the face of arrears to the World Bank Group should continue to require an Agreed Plan between the debtor and the World Bank to clear the arrears over a defined period. Fund financing in the face of arrears to any other IFI should continue to require that a Credible Plan be in place in cases where a contribution from the official sector is not required in order to restore debt sustainability (non-OSI cases). In this context, a Credible Plan is a plan that is credible to the Fund, and the creditor's concurrence is not required.

*Second*, in cases where a contribution from the official sector is required in order to restore debt sustainability (OSI cases):

- Where the member is in arrears to an IFI, the Fund should judge whether a Credible Plan to resolve such arrears is required as a condition for lending. Factors informing the Fund's judgment in this regard will include: (i) global, rather than regional, membership of the institution; (ii) whether the institution is a regional financing arrangement or a reserve currency union central bank that forms part of the global financial safety net; (iii) the Paris Club's treatment of the institution, (iv) participation of the institution in the Heavily Indebted Poor Countries (HIPC) Initiative, and (v) whether the institution is being excluded from the scope of debt restructuring by official bilateral creditors through a creditor committee based on a representative standing forum recognized under the LIOA policy in the case at hand.
- When arrears are owed to an IFI that does not fall under the previous bullet above, Directors agreed that the LIOA policy should be expanded to apply to these cases *mutatis mutandis*. In these cases, the Fund policy will also provide for the flexibility in extraordinary circumstances for emergency financing cases consistent with the LIOA policy.

In the latter cases, the Fund would consider lending into arrears owed to an IFI creditor only in circumscribed circumstances where all the following criteria are satisfied:

- Prompt financial support from the Fund is considered essential, and the member is pursuing appropriate policies;

- The debtor is making good faith efforts to reach agreement with the IFI creditor on a contribution consistent with the parameters of the Fund-supported program—i.e., that the absence of an agreement is due to the unwillingness of the creditor to provide such a contribution; and
- The decision to provide financing despite the arrears would not have an undue negative effect on the Fund’s ability to mobilize official financing packages in future cases.

16. In assessing whether a debtor is acting in good faith, the Fund will consider, inter alia, whether the debtor has approached the IFI creditor to which it owes arrears bilaterally; has offered to engage in substantive dialogue with the IFI creditor and has sought a collaborative process with the creditor to reach agreement; has provided the creditor relevant information on a timely basis consistent with the Fund’s policy on confidentiality of information; and has offered the creditor terms that are consistent with the parameters of the Fund-supported program. If the debtor requested terms from an IFI creditor that would result in financing contributions that exceeded the requirements of the program it would generally not indicate good faith.

17. In assessing whether the Fund’s decision to lend into arrears owed to an IFI creditor would have an undue negative effect on the Fund’s ability to mobilize official financing packages in future cases, the Fund will consider the signal that such a decision would send to IFI creditors, or to official creditors more generally, as a group, given the specific circumstances of the case.

18. An IFI creditor may choose to consent to Fund financing notwithstanding arrears owed to it. Such consent could be conveyed to the Fund either through an Executive Director designated by the IFI or an authorized executive of the IFI to the Managing Director. In such cases, the Executive Board would not need to make a judgment as to whether the three criteria above are satisfied. The Fund would nevertheless continue to encourage the parties to come to an agreement during the program, since the regularization of arrears is an objective of any Fund-supported program and important for the functioning of the international financial system at large.

19. So long as arrears to IFI creditors remain outstanding, purchases or disbursements will be subject to a financing assurances review where the Executive Board will verify that all three criteria are satisfied and the policy continues to be met for the further use of the Fund’s resources in the member’s circumstances.

### **Financing Assurances Reviews**

20. Directors also supported strengthening financing assurances reviews under the LIOA and LIA policies while external arrears remain unresolved, and introducing financing assurances reviews both in cases where arrears are deemed away under Strands 1 and 4 under the LIOA policy and in preemptive restructuring cases needed to restore debt sustainability involving official bilateral creditors until the needed restructuring is complete. Financing assurances reviews would continue to provide the Fund with the opportunity to assess continued compliance with the applicable arrears and financing assurances policies, whether the member’s adjustment efforts are undermined by

developments in debtor and creditor relations, and whether, in light of progress, the debt situation does not undermine the restoration of the member's medium-term external viability and its capacity to repay the Fund.

21. Directors agreed that in cases of unresolved external sovereign arrears subject to a debt restructuring, arrears deemed away under Strands 1 and 4 under the LIOA policy, or where a preemptive restructuring needed to restore debt sustainability is being undertaken that involves official bilateral creditors, requests for new Fund financing should lay out the expected steps and schedule for the restructuring process in an indicative way. Subsequent reviews should detail progress against that schedule taking into account all developments to determine whether the restructuring remains on track to ensure that overall program objectives are met. Directors further supported the proposal that financing assurances reviews should more explicitly assess whether the Fund still has appropriate safeguards to proceed with the financing, or needs to introduce additional standard or enhanced safeguards as warranted.

### **Form of Financing Assurances**

22. For restructuring cases where financing assurances need to be obtained from official bilateral creditors—namely, preemptive cases and Strand 1 and 4 of the LIOA policy—Directors agreed that such assurances could be obtained through the Fund's assessment that a "credible official creditor process" (COCP) is underway. Directors stressed that each creditor would need to establish a track record on which the Fund could base its understanding of the process, key decisionmakers involved, and the expected timeframe for the completion of the debt restructuring, such that an assessment could be made that the key stage had been reached that would provide the Fund with the necessary assurances. Directors noted that, in the absence of sufficient information or a track record to make such an assessment, required financing assurances could continue to be satisfied by specific and credible assurances on debt relief/financing. Directors endorsed the proposal that, in pre-emptive cases, financing assurances would only be sought from a "sufficient set" of creditors, as defined under the enhanced safeguards approach under Strand 4 of the LIOA policy. Directors agreed that the policy for pre-emptive restructuring cases for private creditors remains unchanged.

### **Perimeter**

23. For the purpose of determining the application of the Fund's arrears, financing assurances and debt sustainability policies, Directors broadly agreed with the approach proposed by staff.

24. Specifically, Direct Bilateral Claims will continue to be defined as those claims that are (a) held by a government, or an agency acting on behalf of a government; and (b) originate from an underlying transaction where the creditor government, or an agency acting on behalf of the government, provided or guaranteed financing to the debtor member.

25. In operationalizing this definition, Directors supported using the creditor member's budgetary process to determine which entities form part of the creditor government. For entities

that fall outside the government, a case-by-case analysis, taking into account the totality of the circumstances, would continue to be required to determine whether the entity is “acting on behalf of the government.” Directors recognized that secondary market purchases of claims by official bilateral creditors would not qualify as Direct Bilateral Claims, as they would not directly extend financing to the debtor member.

26. Directors endorsed two amendments to the classification of official claims: First, to the extent that the IFI purchases securities in the secondary market as part of the global financial safety net, such claims can be treated as claims subject to the Fund’s arrears policies as applicable to IFIs; however, the Fund would rely on the IFI’s own representation in this regard. Second, any Direct Bilateral Claims or claims held by IFIs that are contractually part of a pooled voting mechanism with private creditors shall be subject to the LIA policy.

### **Agreement in Principle**

27. Directors recognized the continued utility of the Agreement in Principle (AIP) as an optional procedural device to bridge engagement gaps when agreement on policies has been reached with the member but financing assurances to restore debt sustainability have not been received. They agreed that a few clarifications to the AIP are warranted in such cases. A decision to approve an arrangement in principle shall specify the date by which the approval would lapse, which would normally be no later than 4 months after approval. A new AIP shall only be permitted once and would normally be subject to a limit of an additional 4 months. The Fund would only approve a new AIP if the financing assurances restoring debt sustainability are likely to be delivered, and that the member’s economic program is being implemented as agreed and remains on track. Once the financing assurances have been obtained, a second decision of the Executive Board is required to make the arrangement effective, which is normally adopted on a Lapse of Time basis. Directors stressed that, in all cases, staff should aim to bring a UCT-quality program forward for Executive Board consideration as fast as possible.

### **Effectiveness**

28. The above amendments and new policies will enter into effect immediately and will apply to all future purchases and disbursements (including under existing arrangements), ~~with respect to existing and future arrears~~ where the relevant policies apply.

### **Reviews of the Arrears Policies**

29. Directors agreed that the Fund’s arrears policies should be reviewed on an as needed basis.



April 16, 2024

## POLICY REFORM PROPOSALS TO PROMOTE THE FUND'S CAPACITY TO SUPPORT COUNTRIES UNDERTAKING DEBT RESTRUCTURINGS—SUPPLEMENTARY INFORMATION

Approved By  
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## INTRODUCTION

1. **Staff attaches to this supplement a clean (Annex 1) and redlined (Annex 2) version of the consolidated Executive Board understandings of the Fund’s arrears policies and financing assurances in debt restructuring cases.** These understandings have been updated to reflect the April 9, 2024 Executive Board meeting. Annex 2 shows the differences between the adopted amendments to the policies at such Executive Board meeting and Fund policies in effect before the April 9, 2024 Executive Board meeting.

## **Annex I. Consolidated Draft Executive Board Understanding of the Fund’s Policies with Respect to Arrears and Financing Assurances in Debt Restructuring Cases**

### **Lending Into Arrears (LIA) Policy**

1. Directors concurred that the Fund’s policy on lending into arrears to private creditors continues to provide a useful tool enabling the Fund to support a member’s adjustment efforts before the member has reached agreement with its private creditors on a debt restructuring. Specifically, Directors agreed that Fund lending into sovereign arrears to private creditors should continue to be on a case-by-case basis and only where:
  - (i) prompt Fund support is considered essential for the successful implementation of the member’s adjustment program; and
  - (ii) the member is pursuing appropriate policies and is making a good faith effort to reach a collaborative agreement with its creditors.
  
2. Directors also agreed that Fund lending into non-sovereign arrears stemming from the imposition of exchange controls should continue to be on a case-by-case basis and only where:
  - (i) prompt Fund support is considered essential for the successful implementation of the member’s adjustment program; and
  - (ii) the member is pursuing appropriate policies, the member is making a good faith effort to facilitate a collaborative agreement between private debtors and their creditors, and a good prospect exists for the removal of exchange controls.
  
3. With respect to lending into sovereign arrears to private creditors, Directors agreed that greater clarity about the good faith dialogue between a debtor and its creditors during the restructuring process and enhanced debt transparency could help provide better guidance about the application of the Fund’s LIA policy and, more generally, promote a better framework for the engagement of debtors and creditors in the restructuring of sovereign debt. Greater clarity concerning the framework for possible debt restructuring would strengthen the capacity of investors to assess recovery values under alternative scenarios, thereby facilitating the pricing of risk and improving the functioning of the capital markets. At the same time, however, Directors stressed the need for continued flexibility in applying the “good faith” criterion to accommodate the characteristics of each specific case to avoid putting debtors at a disadvantage in the negotiations with creditors; and to avoid prolonged negotiations that could hamper the ability of the Fund to provide timely assistance. Indeed, any clarification of the “good faith” criterion should serve primarily to support the difficult judgments that will continue to have to be made in each case, and should be made operational in a manner that does not impair market discipline.

4. Directors considered that the following principles would strike an appropriate balance between clarity and flexibility in guiding the dialogue between debtors and their private external creditors.

*First*, when a member has reached a judgment that a restructuring of its debt is necessary, it should engage in an early dialogue with its creditors, which should continue until the restructuring is complete.

*Second*, the member should share relevant information with all creditors on a timely basis, which would generally be aligned with what the member would be required to share under the Debt Limits Policy and normally include:

- an explanation of the economic problems and financial circumstances that justify a debt restructuring;
- a briefing on the broad outlines of a viable economic program to address the underlying problems and its implications on the broad financial parameters shaping the envelope of resources available for restructured claims; and
- the provision of a comprehensive picture of the outstanding debt stock and its terms, and the proposed treatment of all claims on the sovereign, including those of official bilateral creditors; the perimeter of claims subject to the envisaged debt restructuring; and the elaboration of the basis on which the debt restructuring would restore medium-term debt sustainability, bearing in mind that not all categories of claims may need to be restructured.

*Third*, the member should provide creditors with an early opportunity to give input on the design of restructuring strategies and the design of individual instruments.

*Fourth*, any terms offered to the creditors by the member should be consistent with the parameters of the Fund-supported program.

5. Although, as a general premise, the form of the dialogue would continue to be left to the debtor and its creditors, under this approach a member in arrears would be expected to initiate a dialogue with its creditors consistent with the principles discussed above. In cases in which creditors have been able to form a representative committee on a timely basis, there would be an expectation that the member would enter into good faith negotiations with this committee, though the unique characteristics of each case would also be considered.

6. Directors stressed that, in going forward with the suggested approach, it would be crucial to strike the appropriate balance between the need to promote effective communication between a debtor and its creditors, and the need to retain flexibility to address the diversity of individual member circumstances.

7. Directors emphasized that in assessing whether the member is making good faith efforts to negotiate, judgments would continue to be required in a number of important areas. These include a consideration of the extent to which creditor committees are sufficiently representative, and whether a reasonable period has elapsed to allow for the formation of representative committees. In the absence of such creditor committees, the member would be expected to engage creditors through a less structured dialogue.

8. Directors viewed the considerations laid out in the staff paper as useful inputs for helping to make such judgments, which would need to be made flexibly. They also noted that to the extent that negotiations become stalled because creditors are requesting terms that are inconsistent with the adjustment and financing parameters that have been established under a Fund-supported program, the Fund should retain the flexibility to continue to support members notwithstanding the lack of progress in negotiations with creditors.

9. Directors recognized that there may be circumstances where, following a default, the debtor enters into good faith discussions with creditors prior to the approval of a Fund arrangement. In these circumstances, creditors are likely to express views as to the appropriate dimensions of the program's adjustment and financing parameters. While such input would be welcome, Directors emphasized that decisions on an adequate macroeconomic framework and the design of the financing plan or the adjustment program that could form the basis for the Fund's lending into arrears will remain in the sole purview of the Fund.

10. Directors recognized that there may be emergency situations, such as in the aftermath of a natural disaster, where the extraordinary demands on the affected government are such that there is insufficient time for the debtor to undertake good faith efforts to reach agreement with its creditors. When a judgment has been made that such exceptional circumstances exist, the Fund may provide financing under the Rapid Credit Facility (RCF) or the Rapid Financing Instrument (RFI) despite arrears owed to private creditors. However, it would be expected that the Fund's support provided to the debtor in such cases would help advance normalization of relations with private creditors and the resolution of arrears, so that the approval of any subsequent Fund arrangement for the member would again be subject to the LIA policy on lending into sovereign arrears to private creditors.

11. All purchases and disbursements made while a member has outstanding arrears to private creditors will continue to be subject to financing assurances reviews, which will provide an opportunity for the Fund to monitor relations between a debtor and its creditors, and for the Board to be kept informed about developments in this area at an early stage.

12. The policy outlined above supersedes all previous policies regarding lending into arrears to private creditors.

### **Codifying Existing Practice into a Policy in Preemptive Restructuring Cases**

13. Directors agreed that the current practice in preemptive restructuring cases remains appropriate. To the extent that the Fund determines that a contribution from external private

creditors in the form of a debt restructuring will be needed to restore debt sustainability, the restructuring should ideally be undertaken before the approval of the Fund arrangement. However, there may be circumstances under which more flexibility is warranted, so that the conclusion of the debt operation is contemplated at a later date, normally, by the first review under the arrangement. In such cases, the Fund may provide financing only if it has adequate assurances that such a restructuring will be successful. Such assurances are obtained by a judgment that a credible process for restructuring is underway and will result in sufficient creditor participation to restore debt sustainability and close financing gaps within the macroeconomic parameters of the program, taking into account official sector commitments. This judgment will depend on member-specific circumstances, but relevant considerations to inform such judgment may include the engagement of legal and financial advisors by the member, the launching of consultations with creditors, and the design of the debt restructuring strategy, including the terms of the new instruments and use of inducements for creditor participation. Directors welcomed the recommendation to add an expectation that the member would be expected to share relevant information as defined under the LIA policy with all private creditors on a timely basis.

### **Lending Into Arrears to Official Bilateral Creditors (LIOA) Policy**

Directors broadly agreed that the Fund's non-toleration of arrears policy in non-(Official Sector Involvement) OSI cases and the policy on lending into sovereign arrears to official bilateral creditors in OSI cases, covering a three-strand approach, continues to be appropriate, but with adjustments to introduce a fourth strand in the LIOA policy as detailed below. Most Directors agreed that more experience is needed with the Common Framework (CF) and welcomed staff's plan to closely monitor the CF's evolution and revert to the Board on whether it emerges as a new representative standing forum.

14. The LIOA policy is as follows:

*Strand 1:* If an agreement is reached through the Paris Club or the Common Framework involving the Paris Club that is adequately representative, the Fund would rely on its current practices—i.e., arrears would be considered eliminated (for purposes of the application of this policy) for both participating and non-participating creditors when financing assurances are received from the Paris Club or the Common Framework involving the Paris Club in anticipation of an Agreed Minute. Should another representative standing forum emerge, the Fund would be open to engaging with such a forum. Directors agreed that Strand 1 should remain the central focus of this policy and should be used whenever it is or becomes available.

*Strand 2:* An official bilateral creditor may choose to consent to Fund financing notwithstanding arrears owed to it. In such cases, the Board would not need to make a judgment as to whether the three criteria in Strand 3 below are satisfied. The Fund would nevertheless continue to encourage the parties to come to an agreement to resolve arrears, since the regularization of arrears is an objective of any Fund-supported program and important for the functioning of the international financial system at large.

*Strand 3:* In circumstances where an adequately representative agreement has not been reached through the Paris Club, and creditor consent has not been received, the Fund would consider lending into arrears owed to an official bilateral creditor only in circumscribed circumstances where all the following criteria are satisfied:

- Prompt financial support from the Fund is considered essential, and the member is pursuing appropriate policies;
- The debtor is making good faith efforts to reach agreement with the creditor on a contribution consistent with the parameters of the Fund-supported program—i.e., that the absence of an agreement is due to the unwillingness of the creditor to provide such a contribution; and
- The decision to provide financing despite the arrears would not have an undue negative effect on the Fund’s ability to mobilize official financing packages in future cases.

In applying the above criteria, the Fund will need to exercise judgment based on case-specific circumstances. In exercising this judgment, the Board will be guided by the following considerations:

*First*, an agreement will be considered “adequately representative” when it provides a majority of the total financing contributions required from official bilateral creditors over the program period. “Contribution” here comprises, and is limited to, debt relief and new financing (e.g. loans, bond financing, guarantees, and grants).

*Second*, in assessing whether a debtor is acting in good faith, the Fund will consider, inter alia, whether the debtor has approached the creditor to which it owes arrears either bilaterally or through a relevant grouping of official bilateral creditors, recognizing that the latter may take several forms, including ad hoc creditor committees; has offered to engage in substantive dialogue with the creditor and has sought a collaborative process with the creditor to reach agreement; has provided the creditor relevant information on a timely basis consistent with the Fund’s policy on confidentiality of information; and has offered the creditor terms that are consistent with the parameters of the Fund-supported program. If the debtor requested terms from an official bilateral creditor that would result in financing contributions that exceeded the requirements of the program it would generally not indicate good faith. Finally, an assessment of the second criterion would also take into consideration the extent to which a creditor is being asked to make a contribution that is disproportionate relative to other official bilateral creditors.

*Third*, in assessing whether the Fund’s decision to lend into arrears owed to an official bilateral creditor would have an undue negative effect on the Fund’s ability to mobilize official financing packages in future cases, the Fund will consider the signal that such a decision would send to official bilateral creditors as a group, given the specific circumstances of the case. In particular, this criterion would normally not be satisfied where the creditor or group of

creditors that has not reached agreement with the debtor accounts for an adequately representative share, i.e., a majority, of total financing contributions required from official bilateral creditors over the program period, as defined above. Separately, an assessment of whether the third criterion is satisfied would take into consideration the creditor's track record of providing contributions in past debt restructurings under Fund-supported programs, even if the creditor does not account for an adequately representative share of total financing contributions.

*Strand 4:* The Fund shall seek additional safeguards under this policy for Fund lending where an adequately representative agreement has not been reached through the Paris Club or the Common Framework involving the Paris Club, consent is not forthcoming within 4 weeks of being requested, *and* the three criteria under Strand 3 cannot be satisfied with respect to an official bilateral creditor. The approach would distinguish the Fund-supported programs with normal access from those with exceptional access under the GRA or the PRGT or high combined access under the GRA and PRGT.

- In the first case, the “standard safeguards approach” would apply (except as noted below). This would require a combination of program design elements—including the phasing of access under the arrangement (with an initial purchase or disbursement capped at low access), program conditionality to support the restructuring process where warranted under the Guidelines on Conditionality, and a debtor commitment to good faith efforts to establish additional safeguards for Fund lending.
- In the second case, the “enhanced safeguards approach” would apply, which requires the debtor commitment and conditionality under the standard safeguards approach, and in addition a direct commitment to the Fund by a sufficient set of creditors about their restructuring intentions. Where such a commitment is provided, arrears would be considered eliminated (for purposes of the application of this policy) for both participating and non-participating creditors. A “sufficient set” of creditors requires the participation of any representative standing creditor forum as well as any creditors with significant influence over the debtor. For this purpose, a creditor is considered to have significant influence over the debtor when it has the ability to extract repayment on more favorable terms, inconsistent with program parameters.

The standard safeguards approach will normally be sufficient for normal access cases that fall into Strand 4, but complex cases, involving the prospect of prolonged negotiations or creditor coordination issues would necessitate a shift to the enhanced safeguards approach. Thus, the Strand 4 approach would shift to enhanced safeguards based on an explicit signal that a creditor or creditor group to which the three criteria in Strand 3 cannot be satisfied either (1) is unwilling to restructure its or their claims in line with program parameters; or (2) views additional support by the Fund to the debtor's effort to coordinate with creditors to be essential. Directors emphasized that it would be important for a Staff Report to transparently and factually explain which creditor(s) requested it, and the reason for a shift under normal access to the enhanced safeguards approach and to limit stigma associated with any request for this shift.

*Emergency situations:* There may be emergency situations caused by natural disasters and a subset of other exogenous shocks, such as large or global shocks, where the extraordinary demands on the affected government are such that there is insufficient time for the debtor to undertake good faith efforts to reach agreement with its creditors. When a judgment has been made that such exceptional circumstances exist, the Fund may provide financing under the Rapid Credit Facility (RCF) or the Rapid Financing Instrument (RFI) despite arrears owed to official bilateral creditors and without assessing whether the three criteria above have been satisfied or obtaining the creditor's consent. However, it would be expected that the Fund's support provided to the debtor in such cases would help advance normalization of relations with official bilateral creditors and the resolution of arrears, so that the approval of any subsequent Fund arrangement for the member would again be subject to all three criteria set out above. This assessment would be based on the debtor's commitment to make good faith efforts toward resolving the arrears and to conduct itself in a way to promote and encourage creditor coordination. Directors expected that this "exceptional circumstances" clause would generally not be satisfied for cases with long-standing arrears. Directors concurred that new Fund-supported programs should continue to incorporate the assumption that old OSI-related claims would be restructured in line with the terms stipulated in the original Fund-supported program. Should new arrears arise due to the exercise of a comparability of treatment clause, such arrears shall be classified as non-OSI, and thus be subject to the Fund's non-tolerance of arrears policy, regardless of whether an additional debt treatment is required.

### **International Financial Institutions**

15. Directors agreed that application of the non-tolerance of arrears policy with respect to multilaterals has worked well, but the policy needs to be updated to clarify how the policy applies to new International Financial Institutions (IFIs) and to ensure that the special treatment multilateral creditors receive under the Fund's arrears policy is not diluted. IFIs are defined as international financial institutions with at least two sovereign members (and no non-sovereign member). While many Directors expressed a preference for staff's original proposal on this issue (in [Review of the Fund's Sovereign Arrears Policies and Perimeter](#)), which would reduce scope for judgement in this area and provide for more clarity, a number of Directors could not support staff's original proposal. In the end, most Directors went along with the alternative approach set out in Supplement 1 in light of staff's expectation that implementation of the approach described in Supplement 1 would not fundamentally differ from that in the original proposal. Therefore, Directors endorsed the following:

*First*, Fund financing in the face of arrears to the World Bank Group should continue to require an Agreed Plan between the debtor and the World Bank to clear the arrears over a defined period. Fund financing in the face of arrears to any other IFI should continue to require that a Credible Plan be in place in cases where a contribution from the official sector is not required in order to restore debt sustainability (non-OSI cases). In this context, a Credible Plan is a plan that is credible to the Fund, and the creditor's concurrence is not required.

*Second*, in cases where a contribution from the official sector is required in order to restore debt sustainability (OSI cases):

- Where the member is in arrears to an IFI, the Fund should judge whether a Credible Plan to resolve such arrears is required as a condition for lending. Factors informing the Fund’s judgment in this regard will include: (i) global, rather than regional, membership of the institution; (ii) whether the institution is a regional financing arrangement or a reserve currency union central bank that forms part of the global financial safety net; (iii) the Paris Club’s treatment of the institution, (iv) participation of the institution in the Heavily Indebted Poor Countries (HIPC) Initiative, and (v) whether the institution is being excluded from the scope of debt restructuring by official bilateral creditors through a creditor committee based on a representative standing forum recognized under the LIOA policy in the case at hand.
- When arrears are owed to an IFI that does not fall under the previous bullet above, Directors agreed that the LIOA policy should be expanded to apply to these cases *mutatis mutandis*. In these cases, the Fund policy will also provide for the flexibility in extraordinary circumstances for emergency financing cases consistent with the LIOA policy.

In the latter cases, the Fund would consider lending into arrears owed to an IFI creditor only in circumscribed circumstances where all the following criteria are satisfied:

- Prompt financial support from the Fund is considered essential, and the member is pursuing appropriate policies;
- The debtor is making good faith efforts to reach agreement with the IFI creditor on a contribution consistent with the parameters of the Fund-supported program—i.e., that the absence of an agreement is due to the unwillingness of the creditor to provide such a contribution; and
- The decision to provide financing despite the arrears would not have an undue negative effect on the Fund’s ability to mobilize official financing packages in future cases.

16. In assessing whether a debtor is acting in good faith, the Fund will consider, *inter alia*, whether the debtor has approached the IFI creditor to which it owes arrears bilaterally; has offered to engage in substantive dialogue with the IFI creditor and has sought a collaborative process with the creditor to reach agreement; has provided the creditor relevant information on a timely basis consistent with the Fund’s policy on confidentiality of information; and has offered the creditor terms that are consistent with the parameters of the Fund-supported program. If the debtor requested terms from an IFI creditor that would result in financing contributions that exceeded the requirements of the program it would generally not indicate good faith.

17. In assessing whether the Fund’s decision to lend into arrears owed to an IFI creditor would have an undue negative effect on the Fund’s ability to mobilize official financing packages in future cases, the Fund will consider the signal that such a decision would send to IFI creditors, or to official creditors more generally, as a group, given the specific circumstances of the case.

18. An IFI creditor may choose to consent to Fund financing notwithstanding arrears owed to it. Such consent could be conveyed to the Fund either through an Executive Director designated by the IFI or an authorized executive of the IFI to the Managing Director. In such cases, the Executive Board would not need to make a judgment as to whether the three criteria above are satisfied. The Fund would nevertheless continue to encourage the parties to come to an agreement during the program, since the regularization of arrears is an objective of any Fund-supported program and important for the functioning of the international financial system at large.

19. So long as arrears to IFI creditors remain outstanding, purchases or disbursements will be subject to a financing assurances review where the Executive Board will verify that all three criteria are satisfied and the policy continues to be met for the further use of the Fund's resources in the member's circumstances.

### **Financing Assurances Reviews**

20. Directors also supported strengthening financing assurances reviews under the LIOA and LIA policies while external arrears remain unresolved, and introducing financing assurances reviews both in cases where arrears are deemed away under Strands 1 and 4 under the LIOA policy and in preemptive restructuring cases needed to restore debt sustainability involving official bilateral creditors until the needed restructuring is complete. Financing assurances reviews would continue to provide the Fund with the opportunity to assess continued compliance with the applicable arrears and financing assurances policies, whether the member's adjustment efforts are undermined by developments in debtor and creditor relations, and whether, in light of progress, the debt situation does not undermine the restoration of the member's medium-term external viability and its capacity to repay the Fund.

21. Directors agreed that in these cases, requests for new Fund financing should lay out the expected steps and schedule for the restructuring process in an indicative way. Subsequent reviews should detail progress against that schedule taking into account all developments to determine whether the restructuring remains on track to ensure that overall program objectives are met. Directors called for transparency in the staff's assessment on the consistency of debt restructuring plans with program parameters. Directors further support the proposal that financing assurances reviews should more explicitly assess whether the Fund still has appropriate safeguards to proceed with the financing in light of progress with the restructuring, or needs to introduce additional safeguards. They stressed that such additional safeguards should be introduced in a manner well-tailored to the situation and reason for any delay and that a clear signal about a creditor's unwillingness to restructure would motivate a shift to enhanced safeguards.

## Form of Financing Assurances

22. For restructuring cases where financing assurances need to be obtained from official bilateral creditors—namely, preemptive cases and Strand 1 and 4 of the LIOA policy—Directors agreed that such assurances could be obtained through the Fund’s assessment that a “credible official creditor process” (COCP) is underway. Directors stressed the need for clear guidance on the criteria that the assessment could be built on. In this context they noted that each creditor would need to establish a robust track record in delivering timely and successful debt restructurings on which the Fund could base its understanding of the process, key decisionmakers involved, and the expected timeframe for the completion of the debt restructuring, such that an assessment could be made that the key stage had been reached that would provide the Fund with the necessary assurances. They also noted that, in the absence of sufficient information or a robust track record to make such an assessment, required financing assurances could continue to be satisfied by specific and credible assurances on debt relief/financing. Directors stressed that it would be important that assessments of COCP be made in a transparent, evenhanded, and fair manner with enough granularity and robust evidence to allow the Board to make this delicate judgment. Directors agreed that the process of establishing a track record for each of the non-PC creditors’ processes could in principle move broadly at the same speed, since any restructuring case typically involves multiple non-PC creditors.

Directors endorsed the proposal that, in pre-emptive cases, financing assurances would only be sought from a “sufficient set” of creditors, as defined under the enhanced safeguards approach under Strand 4 of the LIOA policy. Directors agreed that the policy for pre-emptive restructuring cases for private creditors remains unchanged.

## Perimeter

23. For the purpose of determining the application of the Fund’s arrears, financing assurances and debt sustainability policies, Directors broadly agreed with the approach proposed by staff.

24. Specifically, Direct Bilateral Claims will continue to be defined as those claims that are (a) held by a government, or an agency acting on behalf of a government; and (b) originate from an underlying transaction where the creditor government, or an agency acting on behalf of the government, provided or guaranteed financing to the debtor member.

25. In operationalizing this definition, Directors supported using the creditor member’s budgetary process to determine which entities form part of the creditor government. For entities that fall outside the government, a case-by-case analysis, taking into account the totality of the circumstances, would continue to be required to determine whether the entity is “acting on behalf of the government.” Directors recognized that secondary market purchases of claims by official bilateral creditors would not qualify as Direct Bilateral Claims, as they would not directly extend financing to the debtor member.

26. Directors endorsed two amendments to the classification of official claims: First, to the extent that the IFI purchases securities in the secondary market as part of the global financial safety net, such claims can be treated as claims subject to the Fund's arrears policies as applicable to IFIs; however, the Fund would rely on the IFI's own representation in this regard. Second, any Direct Bilateral Claims or claims held by IFIs that are contractually part of a pooled voting mechanism with private creditors shall be subject to the LIA policy.

### **Approval in Principle**

27. Directors recognized the continued utility of the Approval in Principle (AIP) as an optional procedural device to bridge engagement gaps when agreement on policies has been reached with the member but financing assurances to restore debt sustainability have not been received. They agreed that a few clarifications to the AIP are warranted in such cases. A decision to approve an arrangement in principle shall specify the date by which the approval would lapse, which would normally be no later than 4 months after approval. A new AIP shall only be permitted once and would normally be subject to a limit of an additional 4 months. The Fund would only approve a new AIP if the financing assurances restoring debt sustainability are likely to be delivered, and that the member's economic program is being implemented as agreed and remains on track. Once the financing assurances have been obtained, a second decision of the Executive Board is required to make the arrangement effective, which is normally adopted on a Lapse of Time basis. Directors stressed that, in all cases, staff should aim to bring a UCT-quality program forward for Executive Board consideration as fast as possible.

### **Effectiveness**

28. The above amendments and new policies will enter into effect immediately and will apply to all future purchases and disbursements (including under existing arrangements), where the relevant policies apply.

### **Reviews of the Arrears Policies**

29. Directors agreed that the Fund's arrears policies should be reviewed on an as needed basis.

## Annex II. Comparison of Draft Executive Board Understanding Against Current Policies

### Introduction

~~1. Directors welcomed the comprehensive review of the Fund's policy on lending into arrears to private creditors, the Fund's policy on lending into sovereign arrears to official bilateral creditors, and the Fund's non-tolerance of sovereign arrears policy to official bilateral and multilateral creditors.~~

~~2. Directors agreed that overall, the Fund's arrears policies have worked well in enabling the Fund to proceed with providing financing in cases of arrears. At the same time, they noted that practice in sovereign debt restructuring and the creditor landscape have evolved over the last 20 years and certain updates are in order.~~

### Lending Into Arrears (LIA) Policy

1. Directors concurred that the Fund's policy on lending into arrears to private creditors continues to provide a useful tool enabling the Fund to support a member's adjustment efforts before the member has reached agreement with its private creditors on a debt restructuring. Specifically, Directors agreed that Fund lending into sovereign arrears to private creditors should continue to be on a case-by-case basis and only where:

- (i) prompt Fund support is considered essential for the successful implementation of the member's adjustment program; and
- (ii) the member is pursuing appropriate policies and is making a good faith effort to reach a collaborative agreement with its creditors.

2. Directors also agreed that Fund lending into non-sovereign arrears stemming from the imposition of exchange controls should continue to be on a case-by-case basis and only where:

- (i) prompt Fund support is considered essential for the successful implementation of the member's adjustment program; and
- (ii) the member is pursuing appropriate policies, the member is making a good faith effort to facilitate a collaborative agreement between private debtors and their creditors, and a good prospect exists for the removal of exchange controls.

3. With respect to lending into sovereign arrears to private creditors, Directors agreed that greater clarity about the good faith dialogue between a debtor and its creditors during the restructuring process and enhanced debt transparency could help provide better guidance about the application of the Fund's LIA policy and, more generally, promote a better framework for the engagement of debtors and creditors in the restructuring of sovereign debt. Greater clarity

concerning the framework for possible debt restructuring would strengthen the capacity of investors to assess recovery values under alternative scenarios, thereby facilitating the pricing of risk and improving the functioning of the capital markets. At the same time, however, Directors stressed the need for continued flexibility in applying the “good faith” criterion to accommodate the characteristics of each specific case to avoid putting debtors at a disadvantage in the negotiations with creditors; and to avoid prolonged negotiations that could hamper the ability of the Fund to provide timely assistance. Indeed, any clarification of the “good faith” criterion should serve primarily to support the difficult judgments that will continue to have to be made in each case, and should be made operational in a manner that does not impair market discipline.

4. Directors considered that the following principles would strike an appropriate balance between clarity and flexibility in guiding the dialogue between debtors and their private external creditors.

*First*, when a member has reached a judgment that a restructuring of its debt is necessary, it should engage in an early dialogue with its creditors, which should continue until the restructuring is complete.

*Second*, the member should share relevant information with all creditors on a timely basis, which would generally be aligned with what the member would be required to share under the Debt Limits Policy and normally include:

- an explanation of the economic problems and financial circumstances that justify a debt restructuring;
- a briefing on the broad outlines of a viable economic program to address the underlying problems and its implications on the broad financial parameters shaping the envelope of resources available for restructured claims; and
- the provision of a comprehensive picture of the outstanding debt stock and its terms, and the proposed treatment of all claims on the sovereign, including those of official bilateral creditors; the perimeter of claims subject to the envisaged debt restructuring; and the elaboration of the basis on which the debt restructuring would restore medium-term debt sustainability, bearing in mind that not all categories of claims may need to be restructured.

*Third*, the member should provide creditors with an early opportunity to give input on the design of restructuring strategies and the design of individual instruments.

*Fourth*, any terms offered to the creditors by the member should be consistent with the parameters of the Fund-supported program.

5. Although, as a general premise, the form of the dialogue would continue to be left to the debtor and its creditors, under this approach a member in arrears would be expected to initiate a dialogue with its creditors consistent with the principles discussed above. In cases in which creditors

have been able to form a representative committee on a timely basis, there would be an expectation that the member would enter into good faith negotiations with this committee, though the unique characteristics of each case would also be considered.

6. Directors stressed that, in going forward with the suggested approach, it would be crucial to strike the appropriate balance between the need to promote effective communication between a debtor and its creditors, and the need to retain flexibility to address the diversity of individual member circumstances.

7. Directors emphasized that in assessing whether the member is making good faith efforts to negotiate, judgments would continue to be required in a number of important areas. These include a consideration of the extent to which creditor committees are sufficiently representative, and whether a reasonable period has elapsed to allow for the formation of representative committees. In the absence of such creditor committees, the member would be expected to engage creditors through a less structured dialogue.

8. Directors viewed the considerations laid out in the staff paper as useful inputs for helping to make such judgments, which would need to be made flexibly. They also noted that to the extent that negotiations become stalled because creditors are requesting terms that are inconsistent with the adjustment and financing parameters that have been established under a Fund-supported program, the Fund should retain the flexibility to continue to support members notwithstanding the lack of progress in negotiations with creditors.

9. Directors recognized that there may be circumstances where, following a default, the debtor enters into good faith discussions with creditors prior to the approval of a Fund arrangement. In these circumstances, creditors are likely to express views as to the appropriate dimensions of the program's adjustment and financing parameters. While such input would be welcome, Directors emphasized that decisions on an adequate macroeconomic framework and the design of the financing plan or the adjustment program that could form the basis for the Fund's lending into arrears will remain in the sole purview of the Fund.

10. Directors recognized that there may be emergency situations, such as in the aftermath of a natural disaster, where the extraordinary demands on the affected government are such that there is insufficient time for the debtor to undertake good faith efforts to reach agreement with its creditors. When a judgment has been made that such exceptional circumstances exist, the Fund may provide financing under the Rapid Credit Facility (RCF) or the Rapid Financing Instrument (RFI) despite arrears owed to private creditors. However, it would be expected that the Fund's support provided to the debtor in such cases would help advance normalization of relations with private creditors and the resolution of arrears, so that the approval of any subsequent Fund arrangement for the member would again be subject to the LIA policy on lending into sovereign arrears to private creditors.

11. All purchases and disbursements made while a member has outstanding arrears to private creditors will continue to be subject to financing [assurances](#) reviews, which will provide an

opportunity for the Fund to monitor relations between a debtor and its creditors, and for the Board to be kept informed about developments in this area at an early stage.

12. The policy outlined above supersedes all previous policies regarding lending into arrears to private creditors.

### **Codifying Existing Practice into a Policy in Preemptive Restructuring Cases**

13. Directors agreed that the current practice in preemptive restructuring cases remains appropriate. To the extent that the Fund determines that a contribution from external private creditors in the form of a debt restructuring will be needed to restore debt sustainability, the restructuring should ideally be undertaken before the approval of the Fund arrangement. However, there may be circumstances under which more flexibility is warranted, so that the conclusion of the debt operation is contemplated at a later date, normally, by the first review under the arrangement. In such cases, the Fund may provide financing only if it has adequate assurances that such a restructuring will be successful. Such assurances are obtained by a judgment that a credible process for restructuring is underway and will result in sufficient creditor participation to restore debt sustainability and close financing gaps within the macroeconomic parameters of the program, taking into account official sector commitments. This judgment will depend on member-specific circumstances, but relevant considerations to inform such judgment may include the engagement of legal and financial advisors by the member, the launching of consultations with creditors, and the design of the debt restructuring strategy, including the terms of the new instruments and use of inducements for creditor participation. Directors welcomed the recommendation to add an expectation that the member would be expected to share relevant information as defined under the LIA policy with all private creditors on a timely basis.

### **Lending Into Arrears to Official Bilateral Creditors (LIOA) Policy**

Directors broadly agreed that the Fund's non-toleration of arrears policy in non-(Official Sector Involvement) OSI cases and the policy on lending into sovereign arrears to official bilateral creditors in OSI cases, covering a three-strand approach, continues to be appropriate ~~and no amendments are needed, but with adjustments to introduce a fourth strand in the LIOA policy as detailed below.~~ Most Directors agreed that more experience is needed with the Common Framework (CF) and welcomed staff's plan to closely monitor the CF's evolution and revert to the Board on whether it emerges as a new representative standing forum.

14. The LIOA policy is as follows:

*Strand 1:* If an agreement is reached through the Paris Club or the Common Framework involving the Paris Club that is adequately representative, the Fund would rely on its current practices—i.e., arrears would be considered eliminated (for purposes of the application of this policy) for both participating and non-participating creditors when financing assurances are received from the Paris Club or the Common Framework involving the Paris Club in anticipation of an Agreed Minute. Should another representative standing forum emerge, the

Fund would be open to engaging with such a forum. Directors agreed that Strand 1 should remain the central focus of this policy and should be used whenever it is or becomes available.

Strand 2: An official bilateral creditor may choose to consent to Fund financing notwithstanding arrears owed to it. In such cases, the Board would not need to make a judgment as to whether the three criteria in Strand 3 below are satisfied. The Fund would nevertheless continue to encourage the parties to come to an agreement to resolve arrears, since the regularization of arrears is an objective of any Fund-supported program and important for the functioning of the international financial system at large.

Strand 3: In circumstances where an adequately representative agreement has not been reached through the Paris Club, and creditor consent has not been received, the Fund would consider lending into arrears owed to an official bilateral creditor only in circumscribed circumstances where all the following criteria are satisfied:

- Prompt financial support from the Fund is considered essential, and the member is pursuing appropriate policies;
- The debtor is making good faith efforts to reach agreement with the creditor on a contribution consistent with the parameters of the Fund-supported program—i.e., that the absence of an agreement is due to the unwillingness of the creditor to provide such a contribution; and
- The decision to provide financing despite the arrears would not have an undue negative effect on the Fund’s ability to mobilize official financing packages in future cases.

In applying the above criteria, the Fund will need to exercise judgment based on case-specific circumstances. In exercising this judgment, the Board will be guided by the following considerations:

*First*, an agreement will be considered “adequately representative” when it provides a majority of the total financing contributions required from official bilateral creditors over the program period. “Contribution” here comprises, and is limited to, debt relief and new financing (e.g. loans, bond financing, guarantees, and grants).

*Second*, in assessing whether a debtor is acting in good faith, the Fund will consider, inter alia, whether the debtor has approached the creditor to which it owes arrears either bilaterally or through a relevant grouping of official bilateral creditors, recognizing that the latter may take several forms, including ad hoc creditor committees; has offered to engage in substantive dialogue with the creditor and has sought a collaborative process with the creditor to reach agreement; has provided the creditor relevant information on a timely basis consistent with the Fund’s policy on confidentiality of information; and has offered the creditor terms that are consistent with the parameters of the Fund-supported program. If the debtor requested terms

from an official bilateral creditor that would result in financing contributions that exceeded the requirements of the program it would generally not indicate good faith. Finally, an assessment of the second criterion would also take into consideration the extent to which a creditor is being asked to make a contribution that is disproportionate relative to other official bilateral creditors.

*Third*, in assessing whether the Fund's decision to lend into arrears owed to an official bilateral creditor would have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases, the Fund will consider the signal that such a decision would send to official bilateral creditors as a group, given the specific circumstances of the case. In particular, this criterion would normally not be satisfied where the creditor or group of creditors that has not reached agreement with the debtor accounts for an adequately representative share, i.e., a majority, of total financing contributions required from official bilateral creditors over the program period, as defined above. Separately, an assessment of whether the third criterion is satisfied would take into consideration the creditor's track record of providing contributions in past debt restructurings under Fund-supported programs, even if the creditor does not account for an adequately representative share of total financing contributions.

~~An official bilateral creditor may choose to consent to Fund financing notwithstanding arrears owed to it. In such cases, the Board would not need to make a judgment as to whether the three criteria above are satisfied. The Fund would nevertheless continue to encourage the parties to come to an agreement during the program, since the regularization of arrears is an objective of any Fund-supported program and important for the functioning of the international financial system at large.~~

Strand 4: The Fund shall seek additional safeguards under this policy for Fund lending where an adequately representative agreement has not been reached through the Paris Club or the Common Framework involving the Paris Club, consent is not forthcoming within 4 weeks of being requested, and the three criteria under Strand 3 cannot be satisfied with respect to an official bilateral creditor. The approach would distinguish the Fund-supported programs with normal access from those with exceptional access under the GRA or the PRGT or high combined access under the GRA and PRGT.

- In the first case, the "standard safeguards approach" would apply (except as noted below). This would require a combination of program design elements—including the phasing of access under the arrangement (with an initial purchase or disbursement capped at low access), program conditionality to support the restructuring process where warranted under the Guidelines on Conditionality, and a debtor commitment to good faith efforts to establish additional safeguards for Fund lending.
- In the second case, the "enhanced safeguards approach" would apply, which requires the debtor commitment and conditionality under the standard safeguards approach, and in addition a direct commitment to the Fund by a sufficient set of creditors about their

restructuring intentions. Where such a commitment is provided, arrears would be considered eliminated (for purposes of the application of this policy) for both participating and non-participating creditors. A “sufficient set” of creditors requires the participation of any representative standing creditor forum as well as any creditors with significant influence over the debtor. For this purpose, a creditor is considered to have significant influence over the debtor when it has the ability to extract repayment on more favorable terms, inconsistent with program parameters.

While the standard safeguards approach will normally be sufficient for normal access cases that fall into Strand 4, but complex cases, involving the prospect of prolonged negotiations or creditor coordination issues would necessitate a shift to the enhanced safeguards approach would be warranted. Thus, the Strand 4 approach would shift to enhanced safeguards based on an explicit signal that a creditor or creditor group to which the three criteria in Strand 3 cannot be satisfied either (1) is unwilling to restructure its or their claims in line with program parameters; or (2) views additional support by the Fund to the debtor’s effort to coordinate with creditors to be essential. Directors emphasized that it would be important for a Staff Report to transparently and factually explain which creditor(s) requested it, and the reason for a shift under normal access to the enhanced safeguards approach and to limit stigma associated with any request for this shift.

Emergency situations: There may be emergency situations, such as in the aftermath of a caused by exogenous shocks or natural disasters and a subset of other exogenous shocks, such as large or global shocks, where the extraordinary demands on the affected government are such that there is insufficient time for the debtor to undertake good faith efforts to reach agreement with its creditors. When a judgment has been made that such exceptional circumstances exist, the Fund may provide financing under the Rapid Credit Facility (RCF) or the Rapid Financing Instrument (RFI) despite arrears owed to official bilateral creditors and without assessing whether the three criteria above have been satisfied or obtaining the creditor’s consent. However, it would be expected that the Fund’s support provided to the debtor in such cases would help advance normalization of relations with official bilateral creditors and the resolution of arrears, so that the approval of any subsequent Fund arrangement for the member would again be subject to all three criteria set out above. This assessment would be based on the debtor’s commitment to make good faith efforts toward resolving the arrears and to conduct itself in a way to promote and encourage creditor coordination. Directors expected that this “exceptional circumstances” clause would generally not be satisfied for cases with long-standing arrears.

So long as unresolved arrears owed to official bilateral creditors are outstanding, every purchase or disbursement made available after the approval of the arrangement will be subject to a financing assurances review by the Board and verification that all three criteria are satisfied to determine whether this policy continues to be met for the further use of the Fund’s resources in the member’s circumstances.

Directors concurred that new Fund-supported programs should continue to incorporate the assumption that old OSI-related claims would be restructured in line with the terms stipulated in the

original Fund-supported program. Should new arrears arise due to the exercise of a comparability of treatment clause, such arrears shall be classified as non-OSI, and thus be subject to the Fund's non-toleration of arrears policy, regardless of whether an additional debt treatment is required.

### International Financial Institutions

15. Directors agreed that application of the non-toleration of arrears policy with respect to multilaterals has worked well, but the policy needs to be updated to clarify how the policy applies to new International Financial Institutions (IFIs) and to ensure that the special treatment multilateral creditors receive under the Fund's arrears policy is not diluted. IFIs are defined as international financial institutions with at least two sovereign members (and no non-sovereign member). While many Directors expressed a preference for staff's original proposal on this issue (in [Review of the Fund's Sovereign Arrears Policies and Perimeter](#)), which would reduce scope for judgement in this area and provide for more clarity, a number of Directors could not support staff's original proposal. In the end, most Directors went along with the alternative approach set out in Supplement 1 in light of staff's expectation that implementation of the approach described in Supplement 1 would not fundamentally differ from that in the original proposal. Therefore, Directors endorsed the following:

*First*, Fund financing in the face of arrears to the World Bank Group should continue to require an Agreed Plan between the debtor and the World Bank to clear the arrears over a defined period. Fund financing in the face of arrears to any other IFI should continue to require that a Credible Plan be in place in cases where a contribution from the official sector is not required in order to restore debt sustainability (non-OSI cases). In this context, a Credible Plan is a plan that is credible to the Fund, and the creditor's concurrence is not required.

*Second*, in cases where a contribution from the official sector is required in order to restore debt sustainability (OSI cases):

- Where the member is in arrears to an IFI, the Fund should judge whether a Credible Plan to resolve such arrears is required as a condition for lending. Factors informing the Fund's judgment in this regard will include: (i) global, rather than regional, membership of the institution; (ii) whether the institution is a regional financing arrangement or a reserve currency union central bank that forms part of the global financial safety net; (iii) the Paris Club's treatment of the institution, (iv) participation of the institution in the Heavily Indebted Poor Countries (HIPC) Initiative, and (v) whether the institution is being excluded from the scope of debt restructuring by official bilateral creditors through a creditor committee based on a representative standing forum recognized under the LIOA policy in the case at hand.
- When arrears are owed to an IFI that does not fall under the previous bullet above, Directors agreed that the LIOA policy should be expanded to apply to these cases *mutatis mutandis*. In these cases, the Fund policy will also provide for the flexibility in extraordinary circumstances for emergency financing cases consistent with the LIOA policy.

In the latter cases, the Fund would consider lending into arrears owed to an IFI creditor only in circumscribed circumstances where all the following criteria are satisfied:

- Prompt financial support from the Fund is considered essential, and the member is pursuing appropriate policies;
- The debtor is making good faith efforts to reach agreement with the IFI creditor on a contribution consistent with the parameters of the Fund-supported program—i.e., that the absence of an agreement is due to the unwillingness of the creditor to provide such a contribution; and
- The decision to provide financing despite the arrears would not have an undue negative effect on the Fund’s ability to mobilize official financing packages in future cases.

16. In assessing whether a debtor is acting in good faith, the Fund will consider, inter alia, whether the debtor has approached the IFI creditor to which it owes arrears bilaterally; has offered to engage in substantive dialogue with the IFI creditor and has sought a collaborative process with the creditor to reach agreement; has provided the creditor relevant information on a timely basis consistent with the Fund’s policy on confidentiality of information; and has offered the creditor terms that are consistent with the parameters of the Fund-supported program. If the debtor requested terms from an IFI creditor that would result in financing contributions that exceeded the requirements of the program it would generally not indicate good faith.

17. In assessing whether the Fund’s decision to lend into arrears owed to an IFI creditor would have an undue negative effect on the Fund’s ability to mobilize official financing packages in future cases, the Fund will consider the signal that such a decision would send to IFI creditors, or to official creditors more generally, as a group, given the specific circumstances of the case.

18. An IFI creditor may choose to consent to Fund financing notwithstanding arrears owed to it. Such consent could be conveyed to the Fund either through an Executive Director designated by the IFI or an authorized executive of the IFI to the Managing Director. In such cases, the Executive Board would not need to make a judgment as to whether the three criteria above are satisfied. The Fund would nevertheless continue to encourage the parties to come to an agreement during the program, since the regularization of arrears is an objective of any Fund-supported program and important for the functioning of the international financial system at large.

19. So long as arrears to IFI creditors remain outstanding, purchases or disbursements will be subject to a financing assurances review where the Executive Board will verify that all three criteria are satisfied and the policy continues to be met for the further use of the Fund’s resources in the member’s circumstances.

### **Financing Assurances Reviews**

20. Directors also supported strengthening financing assurances reviews under the LIOA and LIA policies while external arrears remain unresolved, and introducing financing assurances reviews both

in cases where arrears are deemed away under Strands 1 and 4 under the LIOA policy and in preemptive restructuring cases needed to restore debt sustainability involving official bilateral creditors until the needed restructuring is complete. Financing assurances reviews would continue to provide the Fund with the opportunity to assess continued compliance with the applicable arrears and financing assurances policies, whether the member’s adjustment efforts are undermined by developments in debtor and creditor relations, and whether, in light of progress, the debt situation does not undermine the restoration of the member’s medium-term external viability and its capacity to repay the Fund.

21. Directors agreed that in these cases, requests for new Fund financing should lay out the expected steps and schedule for the restructuring process in an indicative way. Subsequent reviews should detail progress against that schedule taking into account all developments to determine whether the restructuring remains on track to ensure that overall program objectives are met. Directors called for transparency in the staff’s assessment on the consistency of debt restructuring plans with program parameters. Directors further support the proposal that financing assurances reviews should more explicitly assess whether the Fund still has appropriate safeguards to proceed with the financing in light of progress with the restructuring, or needs to introduce additional safeguards. They stressed that such additional safeguards should be introduced in a manner well-tailored to the situation and reason for any delay and that a clear signal about a creditor’s unwillingness to restructure would motivate a shift to enhanced safeguards.

### **Form of Financing Assurances**

22. For restructuring cases where financing assurances need to be obtained from official bilateral creditors—namely, preemptive cases and Strand 1 and 4 of the LIOA policy—Directors agreed that such assurances could be obtained through the Fund’s assessment that a “credible official creditor process” (COCP) is underway. Directors stressed the need for clear guidance on the criteria that the assessment could be built on. In this context they noted that each creditor would need to establish a robust track record in delivering timely and successful debt restructurings on which the Fund could base its understanding of the process, key decisionmakers involved, and the expected timeframe for the completion of the debt restructuring, such that an assessment could be made that the key stage had been reached that would provide the Fund with the necessary assurances. They also noted that, in the absence of sufficient information or a robust track record to make such an assessment, required financing assurances could continue to be satisfied by specific and credible assurances on debt relief/financing. Directors stressed that it would be important that assessments of COCP be made in a transparent, evenhanded, and fair manner with enough granularity and robust evidence to allow the Board to make this delicate judgment. Directors agreed that the process of establishing a track record for each of the non-PC creditors’ processes could in principle move broadly at the same speed, since any restructuring case typically involves multiple non-PC creditors.

Directors endorsed the proposal that, in pre-emptive cases, financing assurances would only be sought from a “sufficient set” of creditors, as defined under the enhanced safeguards approach

under Strand 4 of the LIOA policy. Directors agreed that the policy for pre-emptive restructuring cases for private creditors remains unchanged.

### **Perimeter**

23. For the purpose of determining the application of the Fund's arrears, financing assurances and debt sustainability policies, Directors broadly agreed with the approach proposed by staff.

24. Specifically, Direct Bilateral Claims will continue to be defined as those claims that are (a) held by a government, or an agency acting on behalf of a government; and (b) originate from an underlying transaction where the creditor government, or an agency acting on behalf of the government, provided or guaranteed financing to the debtor member.

25. In operationalizing this definition, Directors supported using the creditor member's budgetary process to determine which entities form part of the creditor government. For entities that fall outside the government, a case-by-case analysis, taking into account the totality of the circumstances, would continue to be required to determine whether the entity is "acting on behalf of the government." Directors recognized that secondary market purchases of claims by official bilateral creditors would not qualify as Direct Bilateral Claims, as they would not directly extend financing to the debtor member.

26. Directors endorsed two amendments to the classification of official claims: First, to the extent that the IFI purchases securities in the secondary market as part of the global financial safety net, such claims can be treated as claims subject to the Fund's arrears policies as applicable to IFIs; however, the Fund would rely on the IFI's own representation in this regard. Second, any Direct Bilateral Claims or claims held by IFIs that are contractually part of a pooled voting mechanism with private creditors shall be subject to the LIA policy.

### **Approval in Principle**

27. Directors recognized the continued utility of the Approval in Principle (AIP) as an optional procedural device to bridge engagement gaps when agreement on policies has been reached with the member but financing assurances to restore debt sustainability have not been received. They agreed that a few clarifications to the AIP are warranted in such cases. A decision to approve an arrangement in principle shall specify the date by which the approval would lapse, which would normally be no later than 4 months after approval. A new AIP shall only be permitted once and would normally be subject to a limit of an additional 4 months. The Fund would only approve a new AIP if the financing assurances restoring debt sustainability are likely to be delivered, and that the member's economic program is being implemented as agreed and remains on track. Once the financing assurances have been obtained, a second decision of the Executive Board is required to make the arrangement effective, which is normally adopted on a Lapse of Time basis. Directors stressed that, in all cases, staff should aim to bring a UCT-quality program forward for Executive Board consideration as fast as possible.

**Effectiveness**

28. The above amendments and new policies will enter into effect immediately and will apply to all future purchases and disbursements (including under existing arrangements), ~~with respect to existing and future arrears~~ where the relevant policies apply.

**Reviews of the Arrears Policies**

29. Directors agreed that the Fund's arrears policies should be reviewed on an as needed basis.