



IMF POLICY PAPER

REFORMING THE FUND'S POLICY ON NON-TOLERATION OF ARREARS TO OFFICIAL CREDITORS

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- The **Staff Report**, prepared by IMF staff and completed on October 14, 2015 for the Executive Board's consideration on December 8, 2015.
- Two **Staff Supplements** titled *Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors—Supplementary Information* and *Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors—Additional Supplementary Information*.
- A **Press Release** summarizing the views of the Executive Board as expressed during its December 8, 2015 consideration of the staff report and the supplements.

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REFORMING THE FUND'S POLICY ON NON-TOLERATION OF ARREARS TO OFFICIAL CREDITORS

EXECUTIVE SUMMARY

Background. As a follow-up to the May 2013 Executive Board's discussion of the paper on *Sovereign Debt Restructuring: Recent Developments and Implications for the Fund's Legal and Policy Framework* (hereinafter, the "2013 Paper"), this paper proposes a reform to the Fund's policy on non-toleration of arrears owed to official bilateral creditors ("NTP") with a view to addressing the major issues related to official sector involvement (OSI) discussed in the 2013 Paper. Unlike the Fund's lending-into-arrears ("LIA") policy for private creditors, the NTP prevents Fund lending to countries if they owe unresolved arrears to official bilateral creditors, unless the arrears are covered by a Paris Club agreement or the creditor consents to the Fund providing financing.

Nature of the problem. As staff foreshadowed in the 2013 Paper, several aspects of the current NTP present challenges in a changing and increasingly diverse landscape for official bilateral finance. For example, the NTP's reliance on the practices and conventions of the Paris Club creates challenges in an environment where a growing number of creditors are non-Paris Club members. In particular, the NTP's dependence on the Paris Club's comparability of treatment principle to deem away arrears to non-Paris Club bilateral creditors is difficult to justify in circumstances where a Paris Club agreement is not sufficiently representative and the bulk of official bilateral claims are held by non-Paris Club creditors. Further, where there is no Paris Club agreement, the current policy can give individual official bilateral creditors a veto over Fund lending decisions, drawing no distinction between creditors that are contributing to the financing requirements of the program and those that are not, thus leaving the system vulnerable to holdouts.

Proposed modification. Staff's proposal envisages a two-step process: in the first step, all creditors would be encouraged to reach a consensus. While the Paris Club is currently a well-established forum for OSI, the Fund would also recognize agreements among creditors reached in other representative fora, should such fora emerge. If an agreement is reached through the Paris Club and the creditor group so formed represents a significant portion of total official bilateral claims, the Fund would rely on its current practices and deem away arrears to nonparticipating creditors based on the Club's comparability of treatment principle. Only when an agreement cannot be reached (i) with a representative group of creditors in the Paris Club, or (ii) with each creditor in an alternative grouping or bilaterally, would the Fund consider lending into arrears owed to official bilateral creditors in carefully circumscribed circumstances. The

decision to lend in these situations would be subject to a need for prompt Fund assistance, an assessment that the debtor is making good faith efforts to reach an agreement and that the absence of a debt restructuring is due to the unwillingness of the creditor to reach an agreement consistent with the parameters of the Fund-supported program, and a judgment on whether the decision to lend could negatively affect the Fund's ability to mobilize official financing packages in the future.

Likely impact. Staff's proposal will strengthen incentives for collective action among official bilateral creditors in situations where OSI is necessary. The two-step process encourages individual official bilateral creditors to be part of a multilateral agreement, thus reducing the risk that the Fund would be prevented from assisting a member in need because certain official bilateral creditors are seeking more favorable treatment of their claims at the expense of other contributing creditors. Importantly, the policy will continue to protect official bilateral creditors, as any decision to lend into arrears will be subject to the debtor's good faith efforts, will be applied in a way that preserves the Fund's ability to mobilize official financing packages in future, and be subject to the Board's approval.

Next steps. If the Board supports the proposed modification, the new policy will apply immediately to all future Fund disbursements (including under existing arrangements) with respect to existing and future arrears owed to official bilateral creditors.

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CONTENTS

I. INTRODUCTION	4
II. REVIEW OF THE CURRENT POLICY	6
III. STAFF'S PROPOSAL	15
IV. NEXT STEPS AND ISSUES FOR DISCUSSION	20
BOXES	
1. Creditor Coordination and the Holdout Problem	13
2. Definition of Official Claim	16
FIGURES	
1. Hiatus Period for New External Bond Issuances During Recent Crises	9
2. NPV Haircuts on Official and Private Creditors in Sovereign Debt Restructurings	9
3. The Changing Composition of Official Bilateral Claims on Low-Income Countries	12
4. Illustration of Main Elements of Staff's Proposed Lending-Into-Official-Arrears Policy	19
TABLES	
1. Official Sector Contributions in Selected Crisis Episodes	10
2. Timeframe and Delivery of Assistance from Non-Paris Club Creditors	14
References	21

I. INTRODUCTION

1. In May 2013, the Executive Board endorsed four work streams designed to review the Fund's legal and policy frameworks in light of recent developments in sovereign debt restructuring.¹

- The first work stream seeks to address the “too little, too late” problem characterizing recent debt restructurings through two complementary reforms to the Fund's exceptional access lending framework: (i) the introduction of a “reprofiling” option for cases where debt is assessed to be sustainable but not with high probability, with a view to making the underlying exceptional access framework more flexible and better calibrated to members' debt situations; and (ii) the elimination of the systemic exemption which—in staff's view—has proven to be ineffective at mitigating contagion and generates moral hazard.² The Executive Board discussed a first paper on this topic in June 2014, and discussions on this issue are ongoing.
- The second work stream is focused on strengthening the contractual framework to address collective action problems. In October 2014, the Board endorsed reforms to contractual provisions in bonds, particularly (i) the modification of *pari passu* provisions to explicitly state that the clause does not require ratable payments to all creditors, and (ii) the inclusion of a collective action clause with a menu of voting procedures, including a “single limb” aggregated voting procedure that allows a qualified majority of creditors to agree to restructure all (or a subset of) affected bond series.³ Since the Board's endorsement, substantial progress has been made in incorporating the enhanced provisions in new international sovereign issuances, and staff has conducted extensive outreach with issuers and stakeholders, and is closely monitoring market developments.⁴ These efforts will continue.
- The third work stream, into which this paper falls, involves reviewing Fund policies on OSI to help facilitate timely and orderly sovereign debt restructurings. This paper focuses on reforming the Fund's NTP with a view to strengthening incentives for collective action and reducing holdout risks in cases where official sector support is required. As was recognized in the 2013 Paper, there are other issues related to OSI that would be addressed in other contexts: the impact of large official sector financing on prospects for market re-access will be covered under the work stream on reform of the exceptional access lending framework; while other cross-over

¹[The Chairman's Summing Up on Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework](#); see also [Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework](#).

²[The Fund's Lending Framework and Sovereign Debt—Preliminary Considerations](#); see also [The Chairman's Summing Up on the Fund's Lending Framework and Sovereign Debt—Preliminary Considerations](#).

³[Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring](#); [The Chairman's Summing Up on Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring](#).

⁴See [Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts](#).

issues between official and private sector involvement will be taken up in the context of the fourth work stream, discussed below.

- The fourth work stream addresses further issues relating to private sector involvement in debt restructurings, including in the context of the Fund's LIA policy. This work stream will address, *inter alia*, the issues of burden-sharing between official and private creditors and the form and nature of debtor-creditor engagement. It is expected that a paper on these issues will be circulated for Board discussion in the first half of 2016.

2. This paper examines the role and changing composition of official lending and, in that light, proposes an amendment to the Fund's policy on non-toleration of arrears owed to official bilateral creditors. In discussing the 2013 Paper, most Executive Directors "saw merit in clarifying the framework for official sector involvement to ensure a more consistent, evenhanded, and transparent approach."⁵ A key aspect of this work is to review the Fund's policy on non-toleration of arrears owed to official bilateral creditors. The existing policy can result in individual bilateral creditors (to which arrears are owed by the member seeking Fund assistance) having a veto over Fund lending decisions. The policy makes no distinction between creditors that are contributing to the financing requirements of the program and those that are not. Staff has previously argued that this policy is vulnerable to holdout behavior by noncontributing creditors and risks disrupting the provision of timely financial assistance, which is at the core of the Fund's mandate. Such risks have grown, of late, as the official creditor landscape has become more diverse. The proposed reforms would seek to reduce these risks, while maintaining appropriate safeguards for official bilateral creditors.

3. The remainder of the paper is structured as follows: Section II discusses the current policy on non-toleration of arrears owed to official bilateral creditors and some important operational concerns that have arisen in this context; Section III presents staff's proposal for amending the policy; and Section IV presents next steps and issues for discussion.

⁵[*The Chairman's Summing Up on Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework.*](#)

II. REVIEW OF THE CURRENT POLICY

4. The Fund maintains a policy of non-toleration of arrears owed to official bilateral creditors. As a general rule, Fund financing cannot be approved, and a review cannot be completed, while arrears owed to official bilateral creditors are outstanding, unless the creditor in question provides its consent to such financing.⁶ As described below, in implementing this policy, as it applies to arrears owed to official bilateral creditors, the Fund applies conventions associated with the Paris Club.⁷ The Fund also maintains a policy of non-toleration of arrears to *multilateral* creditors (as described in Annex I of the 2013 Paper), which this paper does not propose to alter.

5. The rationale of the Fund's arrears policy is rooted in legal principles that seek to avoid disruptions to the international trade and payments system. Two legal principles underpin the scope and application of this policy:

- The arrears policy helps ensure that members resolve their balance of payments problems “without resorting to measures destructive to national and international prosperity,” as mandated by Article 1(v) of the Articles of Agreement. When the arrears policy was initially defined in 1970, the Fund recognized that incurrence of arrears undermined relationships with external creditors and thereby not only exacerbated the member's balance of payments problems in the longer term, but also did damage to the international trade and payments system. Incorporating arrears elimination into the design of Fund-supported programs therefore enabled the Fund both to assist members to achieve sustainable adjustment and to protect the international monetary, payments, and trade systems.⁸
- The arrears policy is designed to “establish adequate safeguards for the temporary use” of Fund resources by limiting members' ability to achieve financing through the accumulation of arrears (Article V, Section 3). Beyond the period of the program, the concerns about the member's ability to repay the Fund would be alleviated only if there was sufficient evidence that the member was making progress in reestablishing its creditworthiness.

6. The policy has evolved since its establishment in 1970, particularly with regard to the type of arrears and the type of creditors covered.

⁶Consent can be conveyed either implicitly (through non-objection at the Board) or explicitly.

⁷The Paris Club is an informal group of creditor countries that operates by consensus to establish terms for the restructuring of official bilateral claims. There are currently 20 permanent members: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Japan, the Netherlands, Norway, the Russian Federation, Spain, Sweden, Switzerland, the United Kingdom, and the United States. On the invitation of the Club, other official bilateral creditors may participate in the Club's proceedings on an ad-hoc basis. The Club has thus far reached 431 agreements with 90 different debtor countries with about US\$583 billion of debt treated. Paris Club restructuring agreements are guided by six principles (solidarity, consensus, information sharing, case-by-case, conditionality, and comparability of treatment). Further details on these principles, as well as past Paris Club agreements, are available on www.clubdeparis.org.

⁸See the Fund's purposes as set out in [Article 1\(i\), \(ii\) and \(iv\)](#).

- *Type of arrears*: Initially, the non-toleration policy was limited to “jurisdictional arrears”—i.e., arrears arising on payments from residents to nonresidents on current international transactions due to exchange restrictions or multiple currency practices imposed by the member government. Further, the policy did not cover arrears arising from a government default on its own external obligations. The policy was extended in 1980 to include arrears incurred by governments as a result of default, as well as arrears arising from capital transactions. However, the arrears policy continues to be limited to *external* arrears—that is, arrears owed to nonresidents.
- *Type of creditors*: The non-toleration policy initially applied to arrears to all external creditors: multilateral, official bilateral, and private. Following the debt crises of the early 1980s—which had led to the “concerted lending” approach and, related to that, the Fund’s policy on financing assurances—financial institutions (primarily commercial banks) became increasingly reluctant to provide financing assurances required by the Fund in the context of Fund-supported programs.⁹ As the Fund cannot lend without such assurances, there was a growing realization that the Fund’s non-toleration policy gave private creditors an effective veto over Fund lending. In 1989, the Fund’s arrears policy was modified to tolerate arrears to external private creditors during a Fund-supported program under certain conditions. This became known as the LIA policy.¹⁰ In its endorsement of the LIA policy, the Board confirmed that the Fund’s policy of non-toleration of arrears to official creditors would remain unchanged.^{11 12}

7. The scope of the existing policy on non-toleration of arrears owed to official bilateral creditors was determined by the Board. In 1989, in proposing the LIA policy, staff recommended that the relevant criterion for Fund lending into arrears would be the creditor’s unwillingness to contribute rather than its official or private status. Specifically, the LIA policy would not apply to arrears to international financial institutions, the Paris Club, and other creditors contributing to financing requirements of the program. However, Executive Directors rejected staff’s proposal, preserving the right of an individual official creditor to exercise a veto over Fund financing, regardless of whether the creditor was making a contribution to the financing requirements of the program. By contrast, under the LIA policy for private creditors, Fund lending is permitted when

⁹For a description of the policy on financing assurances and how it interacts with the Fund’s policies on arrears, see [2013 Paper, Annex I](#).

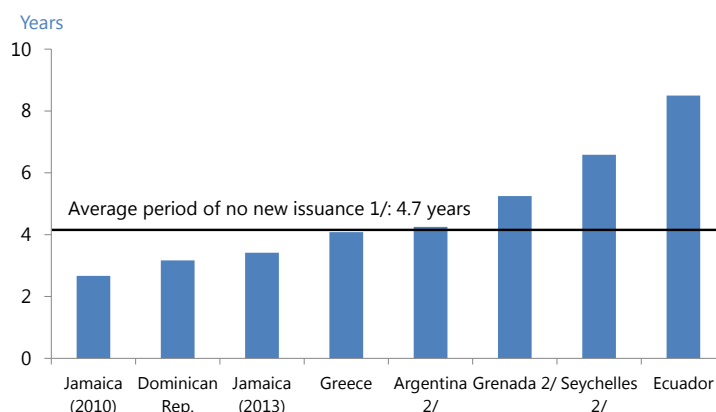
¹⁰Under the LIA policy, the Fund may lend to a member in arrears on a case-by-case basis and only where (i) prompt Fund support is considered essential for the successful implementation of the member’s adjustment program, and (ii) the member is pursuing appropriate policies and is making a good faith effort to reach collaborative agreement with its creditors. For further explanation of the LIA policy, see 2013 Paper, Annex I. For a further description of “good faith” in the LIA context, see [Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good-Faith Criterion](#).

¹¹ For a description of the policy as applied to official multilateral creditors, see [2013 Paper, Annex I](#).

¹²The policy was revised again in 1998 and 1999 to expand the LIA policy from commercial banks to private creditors more generally, including private bondholders. See [Fund Policy on Sovereign Arrears to Private Creditors—Further Considerations; Summing Up by the Acting Chairman on Fund Policy on Arrears to Private Creditors—Further Considerations](#). For further discussion of the LIA policy, see [2013 Paper, Annex I](#).

there are arrears to creditors that are not contributing to the Fund-supported program, as long as the debtor is assessed to be making good faith efforts to reach an agreement.

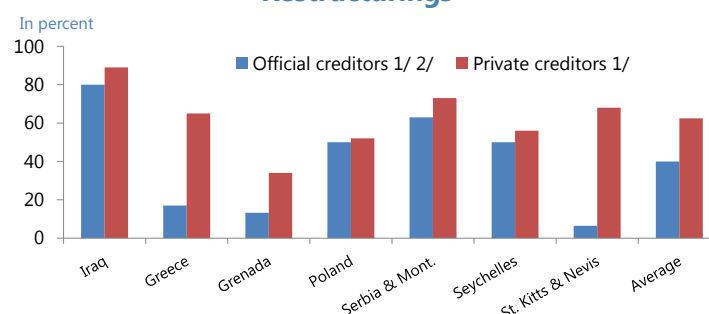
8. From the perspective of official creditors, preferential treatment of their claims, relative to private claims, is justified on the basis of their special role in global finance. The logic is that official creditors typically do not provide financial support to make a profit but rather for public policy reasons. As further discussed below, there is evidence that a lot of official bilateral lending happens in crisis periods when the private sector becomes unwilling to provide support—the hiatus period for new external bond issuances in crisis cases is about 5 years, on average (Figure 1). It follows that this differential feature of official finance should have implications when a member's debt is restructured. Concretely, official creditors take the position that they should have more leverage over the debtor and should receive a more favorable debt treatment than provided to private creditors. The latter is indeed borne out by the actual terms of the treatment offered to official creditors under Paris Club agreements in the past, which typically have been more favorable than those received by private creditors (Figure 2).

Figure 1. Hiatus Period for New External Bond Issuances During Recent Crises

Source: Asonuma and Trebesch (forthcoming), Dealogic, Country desks' inputs.

1/ From the last external bond issuance before restructurings to the first external bond issuance since completion of restructurings.

2/ From the last external bond issuance before restructurings to the first domestic bond issuance since completion of restructurings.

Figure 2. NPV Haircuts on Official and Private Claims in Sovereign Debt Restructurings

Source: Asonuma and Ranciere (2015), Cruces and Trebesch (2013), Paris Club, Zettelmeyer and others (2013) and Staff's calculation.

1/ NPV haircut = $1 - \text{PV of New instrument} / \text{PV of Old instruments}$ as defined in Struzenneger and Zettelmeyer (2006).

2/ For both ODA and non-ODA loans in official debt restructurings, the discount rate is assumed to be the market rate prevailing at the time of the exchange. The 2-percent coupon rate on ODA loans is based on a simple average of concessional terms provided by Paris Club creditors to a sample of HIPC episodes. The coupon rate on non-ODA loans is assumed to be market based and is calculated as the 6-month average of the Commercial Interest Reference Rates (CIRR) as published by the OECD.

9. Moreover, the financing that official bilateral creditors provide during crises is often critical for the success of Fund-supported programs. Members typically approach the Fund for assistance at a time when private creditors are unwilling to extend credit. The Fund's ability to put together an adequately financed program then depends in good measure on securing timely financing contributions from official bilateral creditors. A survey of selected Fund-supported programs since the mid-1990s suggests that such contributions have, on average, been equal to those of the Fund and other international financial institutions combined, although there are notable exceptions (Table 1). This highlights the importance of minimizing instances of arrears owed to official bilateral creditors, especially where these arrears could undermine the Fund's ability to mobilize official financial support packages in the future.

Table 1. Official Sector Contributions in Selected Crisis Episodes

Member	Arrangement Type	Year	Total contribution 1/ (US\$ billion)	Shares in percent 1/	
				IMF+other IFIs	Bilateral
Mexico	SBA	1995	48.8	36.5	63.5
Thailand	SBA	1997	16.0	43.8	56.3
Indonesia	SBA	1997	33.0	54.5	45.5
Korea	SBA	1997	55.0	63.6	36.4
Brazil	SBA	1998	42.0	64.3	35.7
Iceland	SBA	2008	10.2	19.6	80.4
Latvia	SBA	2008	5.8	27.9	72.1
Greece	SBA	2010	146.5	27.3	72.7
Ireland	EFF	2010	90.2	33.4	66.6
Portugal	EFF	2011	115.7	33.3	66.7
Greece	EFF	2012	227.5	16.2	83.8
Jordan	SBA	2012	4.2	57.0	43.0
Cyprus	EFF	2013	13.1	10.0	90.0
Ukraine 2/	EFF	2015	34.2	81.0	19.0
Average				48.0	52.0

Sources: Staff reports and inputs from Fund staff.

1/ Projections at the time of the program request.

2/ Contributions from other IFIs and bilateral creditors include project financing to the public and private sectors.

10. Finally, in distinguishing official from private creditors, the Board has emphasized during past discussions of the LIA policy the difference in the predictability with which a debt restructuring could be organized.¹³ Experience had demonstrated that official restructurings—at a time when most important providers of bilateral official finance were members of the Paris Club—were achieved in a predictable and organized manner, thanks to the practices of the Paris Club (see below), while the process for private restructurings had proved to be unpredictable, compromising the Fund's ability to provide timely balance of payments assistance.

11. The Fund's implementation of the NTP has relied on the well-established practices of the Paris Club, with which Fund staff works closely. The predictability of the Paris Club's negotiating process and its track record of support for orderly restructurings has enabled this reliance.

- Arrears owed to official bilateral creditors covered by the anticipated terms of a Paris Club "Agreed Minute" are deemed eliminated for Fund-supported program purposes when financing assurances are received from the Paris Club prior to the approval of a request for use of Fund

¹³For instance, see [Fund Policy on Arrears to Private Creditors—Further Considerations; Summing Up by the Acting Chairman on Fund Policy on Arrears to Private Creditors—Further Considerations](#).

resources or completion of a review.¹⁴ Importantly, for purposes of the non-toleration policy, arrears to nonparticipating bilateral creditors are similarly deemed eliminated for program purposes, as the Fund has relied on the Paris Club's comparability of treatment principle and assumed that these creditors will restructure the member's debts on similar terms.¹⁵ Accordingly, in circumstances where a Paris Club Agreed Minute exists, nonparticipating official bilateral creditors do not have a veto over Fund support. To the extent that bilateral agreements implementing the Paris Club terms have not been signed by the deadline specified in the Agreed Minute, arrears will be treated as having emerged anew unless the Fund judges that the debtor member is using its best efforts to conclude such agreements.¹⁶

- Where there is no Paris Club Agreed Minute, Fund support can still proceed where arrears exist if the creditor in question consents to such support, generally through non-objection to Fund financial support at the Executive Board meeting by the Executive Director representing the creditor country. Thus, where there is no Paris Club Agreed Minute—either because Paris Club creditors do not have material claims on the country, or the Paris Club did not provide a treatment for other reasons—creditors which are owed arrears do have a veto over Fund lending decisions.¹⁷

12. However, in light of the significant increase in the share of official financing from non-Paris Club creditors there are good reasons for the Fund to revisit the reliance on Paris Club practices and processes for the purposes of the non-toleration policy.

- **The first concern** is that, where the majority of arrears are owed to non-Paris Club creditors, relying on the Paris Club's comparability of treatment to deem those arrears eliminated leads to a situation where the "tail is wagging the dog." In the last decade or so, the Paris Club's share in total bilateral flows has been steadily declining, while that of non-Paris Club official creditors has risen. Large emerging economies like China, Brazil and India, and other non-Paris Club creditors that provide significant bilateral official financing such as Saudi Arabia, now account for the major share of official bilateral claims on low-income countries (Figure 3).¹⁸

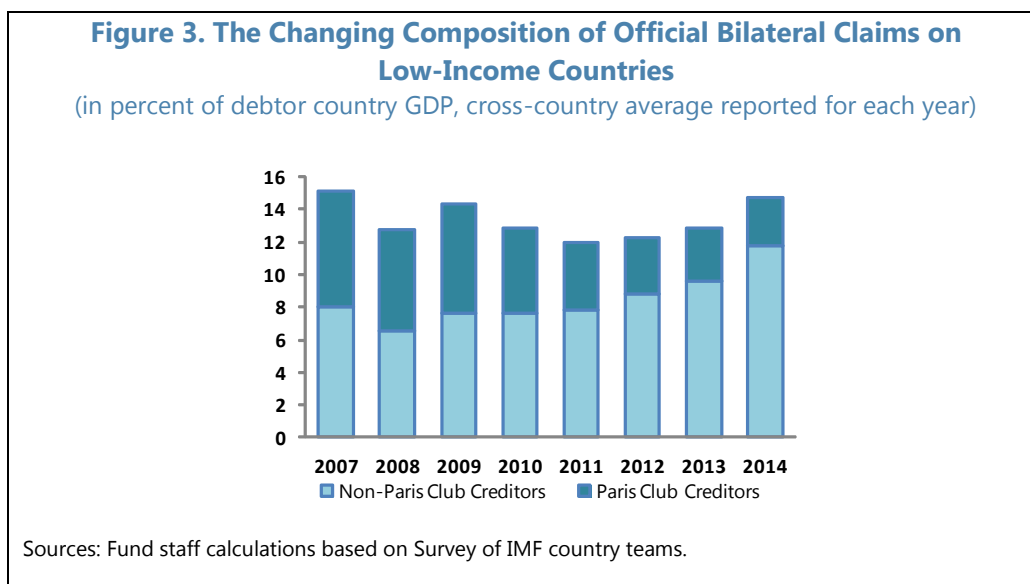
¹⁴The "Agreed Minute" describes the agreement negotiated between the sovereign debtor and Paris Club creditors (including any ad-hoc participants). While the Agreed Minute is not legally enforceable, it provides the basis for the bilateral agreements between the debtor and each participating creditor that are subsequently agreed upon.

¹⁵Under the comparability of treatment principle, the agreement reached between the debtor and Paris Club creditors requires the debtor to seek treatment from non-Paris Club creditors (official or private) that is no more favorable (to the creditor) than that provided by Paris Club creditors.

¹⁶See [2013 Paper, Annex I](#).

¹⁷The consent requirement originated in cases of emergency assistance but has since been expanded to all cases falling short of a Paris Club Agreed Minute.

¹⁸In part this is due to the provision of large-scale debt relief by Paris Club creditors to highly-indebted poor countries (HIPC).



- The second (related) concern** is that the application by non-Paris Club creditors of the comparability of treatment principle—on which the Fund’s arrears policy depends—has become more complex and uneven. Recent experience has demonstrated that there is a great deal of variation in the provision of “comparable” debt relief by non-Paris Club creditor countries. For instance, the HIPC Initiative (which is now almost complete for 36 of the 39 designated HIPCs) shows the challenge of securing comparable participation of non-Paris Club official bilateral creditors (and private commercial creditors) from the very start of the HIPC Initiative. Indeed, non-Paris Club creditors have delivered less than half of the total debt relief expected from them. Moreover, the speed with which relief has been provided is quite slow, with about two fifths of the non-Paris Club creditors yet to participate (Table 2).¹⁹ Similarly, a survey of selected Paris Club debt treatments for non-HIPCs since the early 2000s suggests that debt relief from non-Paris Club creditors fell well short of expectations, with only a handful of cases in which more than four-fifths of the expected relief (i.e., that implied by the comparability-of-treatment principle) was delivered.
- The third concern** relates to the lack of predictability with which official restructurings can be organized outside the Paris Club. Until now, the Fund has been able to rely on close communication and repeat interactions with the Paris Club to predict official bilateral creditor behavior. With the rise of important creditors acting outside that forum, and the fact that they do not themselves belong to any other well-established forum, the problems of achieving creditor coordination in an official restructuring have become more pronounced. In particular, staff has expressed concern, also shared by the Board,²⁰ about the possibility of a holdout

¹⁹The most commonly cited reasons for delay included, *inter alia*, lack of diplomatic relations between debtor and creditor, and difficult political environments either in debtor or creditor countries.

²⁰[The Chairman’s Summing Up on Sovereign Debt Restructuring—Recent Developments and Implications for the Fund’s Legal and Policy Framework; 2013 Paper 1s 48–49 and Box 3.](#)

official creditor effectively vetoing Fund lending decisions. Box 1 briefly summarizes how the holdout problem can arise in sovereign debt restructurings.²¹

Box 1. Creditor Coordination and the Holdout Problem

The holdout problem is a classic example of a coordination failure that leaves stakeholders as a group worse-off relative to a collaborative solution. The introduction of collective action clauses (“CACs”) in private bond contracts and the staff’s proposed reform to the Fund’s arrears policy would help mitigate holdout problems for private and official creditors, respectively.

When a sovereign seeks a debt restructuring, individual creditors can have the incentive to “hold out” of the deal in the hope that they can receive a better payout on their claim at the expense of those creditors that participate in the debt restructuring and agree to write down (or otherwise modify) the value of their claims. The holdout creditor would only be able to receive better terms on their debt because the value of the claims of other creditors would have been reduced, increasing the sovereign’s capacity to service its debt, or because the holdouts anticipate additional support from the official sector. These holdout creditors “free ride” on the negotiated settlement. However, when all creditors act in this manner, a coordinated settlement cannot be reached. This causes delay in resolving the debt crisis and a potential default, raising costs to all parties. Such coordination problems are particularly acute in a pre-default setting where time is of the essence and creditors know they have greater leverage on the debtor that wants to avoid default.

Such coordination problems can occur for both private and official creditors. For private creditors, this problem has been mitigated by the introduction of CACs in bond contracts. Such clauses bind minority holdout creditors into a debt restructuring deal agreed between the debtor and a qualified majority of consenting creditors.¹ For official creditors, the problem was attenuated due to the Paris Club acting to coordinate a relatively small group of major official creditors. But the growing number and diversity of official creditors outside the Paris Club has increased the system’s vulnerability to coordination problems going forward. The proposed change in the Fund’s arrears policy—which in its current form can result in each official bilateral creditor having a veto over Fund lending decisions—will help reduce this risk by making it harder for noncontributing creditors to receive full payment on their debt at the expense of contributing creditors.

¹The Fund recently advocated the use of ‘enhanced CACs’, which can bind creditors across several bond series. See [Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring](#).

²¹Besides the issues discussed here, there may be situations in which Paris Club members themselves do not wish to work through the Paris Club process, thus further complicating the Fund’s lending decisions. For instance, in the case of Greece (2011–12), the country’s bilateral creditors, most of which were Paris Club members, decided to provide debt service relief to Greece, but *outside* the Paris Club framework.

Table 2. Timeframe and Delivery of Assistance from Non-Paris Club Creditors

HIPC Country ^{1/}	E-HIPC Decision Point (DP) Year	E-HIPC Completion Point Year	Time frame in which bilateral agreements were signed	Percentage of creditors who signed agreements	Average time (in years) between DP and agreement dates	Percentage of required relief that was delivered by creditors who signed agreements ^{2/}
Afghanistan	2007	2010	2005 - 2014	86	4	92
Benin	2000	2003	2004 - 2007	75	5	95
Bolivia	2000	2001	2004 - 2008	75	6	58
Burkina Faso	2000	2002	2004 - 2010	43	7	34
Burundi	2005	2009	2007 - 2009	100	3	58
Cameroon	2000	2006	2000 - 2007	100	3	79
Central African Republic	2007	2009	2009 - 2009	14	2	20
Comoros	2010	2012	2012 - 2013	75	3	81
Congo Rep. of	2006	2010	2007 - 2010	50	2	29
Congo, Democratic Rep. of	2003	2010	2005 - 2013	42	5	41
Cote d'Ivoire	2009	2012	2011 - 2011	25	2	73
Ethiopia	2001	2004	2000 - 2010	80	4	25
Gambia, The	2000	2007	2008 - 2008	20	8	9
Ghana	2002	2004	2002 - 2004	80	1	76
Guinea	2000	2012	2006 - 2009	42	7	80
Guinea-Bissau	2000	2010	2001 - 2013	45	8	18
Guyana	2000	2003	2003 - 2008	33	6	29
Honduras	2000	2005	2007 - 2008	29	8	30
Liberia	2008	2010	2007 - 2012	75	4	23
Madagascar	2000	2004	2001 - 2010	75	6	80
Malawi	2000	2006	2007 - 2007	67	7	32
Mali	2000	2003	2001 - 2010	38	5	83
Mauritania	2000	2002	2002 - 2012	88	7	76
Mozambique	2000	2001	2001 - 2011	44	6	65
Nicaragua	2000	2004	1996 - 2014	72	6	43
Niger	2000	2004	2001 - 2011	63	6	54
Rwanda	2000	2005	2001 - 2011	80	6	79
São Tomé and Príncipe	2000	2007	2008 - 2011	40	10	41
Senegal	2000	2004	2005 - 2010	38	7	41
Sierra Leone	2002	2006	2001 - 2008	100	4	90
Tanzania	2000	2001	2001 - 2006	35	4	53
Togo	2008	2010	2010 - 2012	67	3	98
Uganda	2000	2000	2001 - 2013	64	6	64
Zambia	2000	2005	2001 - 2007	43	6	60
Average ^{3/}				59	5	48

1/ This table is based on the latest (2014) HIPC progress report and excludes Chad (which reached its completion point in 2015) and Haiti.

2/ Percent of required relief delivered based on end-2013 PV terms.

3/ Refers to simple average for number of creditors that have provided relief and the time taken for delivery of relief; and average, weighted by required debt relief, for the delivery rate (last column).

III. STAFF'S PROPOSAL

13. Staff proposes revising the arrears policy to permit lending into official bilateral arrears in carefully circumscribed circumstances (Figure 4). The proposal is based on the general principle that the Fund should be able to lend into arrears owed to an official bilateral creditor in circumstances where an assessment has been made that the debtor is making good faith efforts to reach an agreement and that the existence of arrears is exclusively due to the unwillingness of the official bilateral creditor to provide support consistent with the parameters of the Fund-supported program—either in the form of restructuring or the provision of new financing.

14. In applying the proposed policy, the Fund would continue to seek a Paris Club process as a primary vehicle for restructuring official bilateral claims. Treating the Paris Club as the first “port of call” in the application of the policy recognizes the current position of the Paris Club as a well-established forum for collective treatment of debt by bilateral official creditors. Should a new representative forum for OSI emerge, the Fund would similarly urge the creditors involved to reach consensus within that forum. Meanwhile, the Fund will continue to encourage official creditors that are not part of the Paris Club to participate in the Paris Club negotiation on an ad-hoc basis.²²

15. If an agreement is reached through the Paris Club in cases where Club creditors account for a significant share of the debtor’s claims, the Fund would essentially be able to rely on its current practices. Arrears would be considered resolved for both participating and nonparticipating creditors when financing assurances are received from the Paris Club in anticipation of the Agreed Minute.²³

²²The Club has been conducting extensive outreach to large emerging creditors to familiarize them with Paris Club practices. For example, China has participated in several of the Club’s tour d’ horizon sessions though it has not yet participated in a negotiation on an ad-hoc basis. Other countries such as South Africa have participated in negotiations on an ad-hoc basis. An expansion of the Paris Club to include, for instance, large emerging creditors is an issue for the Club to address and would likely be complementary to staff’s proposal.

²³The Fund would also continue to rely on the Paris Club in defining what constitutes an “official claim” to ensure consistency of treatment (Box 2).

Box 2. Definition of Official Claim

The Fund does not have an explicit definition of what constitutes an official claim and has relied on the Paris Club practices for this purpose.

For the purposes of the policy on non-toleration of arrears owed to official creditors, the Fund has not explicitly defined what constitutes an official claim, and thereby an arrear to an official creditor. However, the Paris Club is the forum where most official bilateral claims have been restructured and, accordingly, a review of the types of claims that are restructured within that forum is instructive. Restructured claims generally include (concessional and non-concessional) lending by either creditor governments or, alternatively, by an agency of the government that is acting on behalf of the government. They also include (concessional and non-concessional) credits guaranteed by the government in the creditor country or by an agency, such as an export credit agency, acting on behalf of the government, once the guarantee is called. In such cases, the guarantee of the government, or its export credit agency acting on behalf of the government, makes possible the provision of financing to the debtor country which would not be available on similar terms and amounts without such an official guarantee.

The Fund's own approach has been consistent with Paris Club practices. In assessing whether a claim is official, the Fund has focused on whether the claim (a) is held by the government, or an agency acting on behalf of the government; and (b) originates from an underlying transaction where the creditor government, or an agency acting on behalf of the government, provided or guaranteed financing to the borrowing country. This practice has been applied to both Paris Club and non-Paris Club creditors.

16. However, there may be circumstances where an agreement has not been reached through the Paris Club or where the Paris Club agreement is not sufficiently representative of creditors. A number of situations can be envisaged. For instance, there may be no Paris Club creditors; or Paris Club claims may not comprise a significant share of total bilateral official sector claims on the debtor—in which case it would be inappropriate to automatically deem the arrears of other creditors eliminated. If such situations arise, debt negotiations may need to be pursued on a bilateral basis or under alternative groupings of creditors. If an agreement can be reached with each official creditor through such processes, there would be no issue—the Fund-supported program could proceed.

17. In considering the circumstances where the Fund would be prepared to tolerate arrears, the Fund would need to ensure that such a step would not have a negative impact on its ability to mobilize adequate official financing support in the future. As discussed above (paragraph 9), it is important that the Fund's arrears policy remain consistent with its catalytic role in crisis situations, which rests critically on securing timely and adequate support from official bilateral creditors. Circumstances may arise where—although the sovereign is acting in good faith to reach an agreement and the arrears are exclusively due to the unwillingness of the creditor to contribute to the financing of the program—there is a risk that lending into arrears owed to an official bilateral creditor could negatively affect the Fund's ability to mobilize adequate official financing packages in future cases.

18. In light of the above considerations, the Fund would consider lending into arrears owed to an official bilateral creditor only in circumstances where all the following conditions are satisfied:

- prompt financial support from the Fund is considered essential, and the member is pursuing appropriate policies;
- the Paris Club has not provided financing assurances, or a Paris Club Agreed Minute does not exist, or the Paris Club process is not sufficiently representative of the creditor base and an agreement with each official creditor bilaterally or under alternative groupings has not otherwise been reached;
- the Fund assesses that the debtor is making good faith efforts and that the absence of a debt restructuring is due to the unwillingness of the creditor to reach an agreement consistent with the parameters of the Fund-supported program. Analogous to the application of good faith under the LIA policy for private creditors, it would be expected that the debtor should engage in substantive dialogue with the creditor(s) to which it is in arrears, guided by some of the principles set out for the private sector context in 2002 (also see Annex I of the 2013 Paper);²⁴
- the Fund assesses that the decision to lend into arrears would not have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases. This assessment would take into consideration, *inter alia*, the reliability of the creditor's provision of support in past debt restructurings under Fund-supported programs.

19. The decision on whether the arrears arise from the absence of good faith behavior by the debtor or, alternatively, from the unwillingness of the creditor to contribute despite the debtor's good faith efforts, would rest with the Board. In exercising this judgment, Executive Directors would consider whether the lack of an agreement is due to actions by the debtor (lack of good faith efforts) or by the creditor despite debtor good faith (i.e., a holdout problem). If the Board determines that the failure to reach agreement is due to lack of good faith on the part of the debtor, and not the unwillingness of the creditor to contribute to the financing of the program, the arrears would not be tolerated and the program would stop. Any assessment of whether the creditor is contributing to the financing of the program will consider the provision of new financing as well as debt restructuring.²⁵ Thus, whether a creditor is maintaining/increasing exposure during the program period would be taken into account in assessing whether there has been adequate contribution consistent with the parameters of the Fund-supported program.

²⁴[Fund Policy on Lending Into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion](#). Some of the principles could naturally vary between private and official creditors. For instance, official creditors already may have access to confidential information through the Fund's Executive Board, while private creditors should be provided relevant, non-confidential information on a timely basis.

²⁵"Contribution" for the purposes of the proposed policy only includes financial support that directly helps meet the program's financing and/or debt sustainability targets.

20. As under the current policy, an official bilateral creditor may choose to consent to arrears. This may arise because the creditor is not in a position to agree to a restructuring or provide new financing. Since the consent to arrears would constitute a form of financing contribution to the program, this would continue to be acceptable to the Fund. In these cases, the Board would not need to make a judgment as to whether the four criteria above are satisfied.²⁶ 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 financial system at large.

21. There may also be emergency situations (such as in the aftermath of a natural disaster) where there is insufficient time for the debtor to undertake good faith efforts. When a judgment has been made that such exceptional circumstances exist, it is proposed that the policy should provide flexibility to allow the Fund to lend under the Rapid Credit Facility or the Rapid Financing Instrument without the four criteria being satisfied. However, as under the current policy, it would be expected that the Fund 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 four criteria set out in paragraph 18.

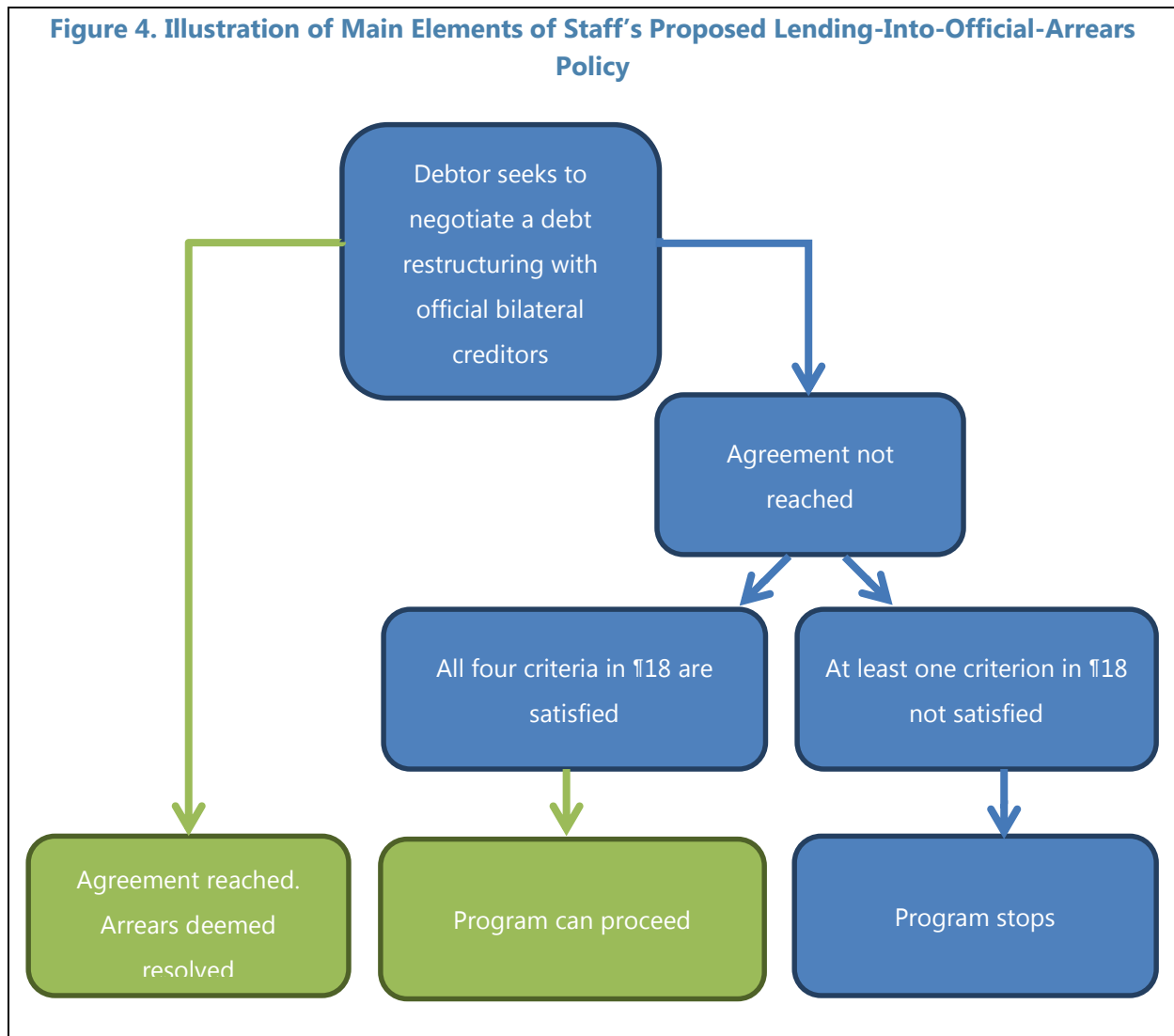
22. The policy would be applied at the time of every disbursement or purchase so long as arrears owed to official bilateral creditors are outstanding. As with the current policy, the Board would apply the proposed policy at the time of the approval of the financing and at each program review so long as arrears owed to official bilateral creditors are outstanding. Further, in line with the requirement under the LIA policy, so long as arrears owed to official bilateral creditors are outstanding, the Board would conduct a financing assurances review to determine whether adequate safeguards remain in place for the further use of the Fund's resources in the member's circumstances and whether the member's adjustment efforts are undermined by developments in creditor-debtor relations. More specifically, every purchase or disbursement made available after the approval of the arrangement will, while such arrears remain outstanding, be made subject to the completion of a financing assurances review and verification that all four criteria are satisfied.

23. Finally, it is important to note that staff's proposal is designed to strengthen incentives for collective action among official bilateral creditors in situations where OSI is necessary. While the Fund's practices may need to evolve in the future, if and when new fora for official creditor coordination emerge, the Paris Club has so far served as a well-established forum for such collective action. Staff's proposed policy recognizes this by encouraging all creditors, including non-Paris Club creditors, to first reach a consensus within the Paris Club. If an agreement is reached through the Paris Club and the creditor group represents a significant portion of total official bilateral claims, the Fund would be able to deem away arrears to nonparticipating creditors by invoking the comparability of treatment principle. Only when an agreement cannot be reached

²⁶In the event that the creditor revokes its consent at any time, the Fund could continue to provide support as long as the four criteria are satisfied.

(i) within the Paris Club (or the agreement is not representative of the creditor base), or (ii) with each creditor bilaterally or under alternative groupings, would the Fund consider lending into arrears owed to official bilateral creditors subject to, *inter alia*, a good faith assessment for the debtor. This two-step process is designed to help strengthen incentives for individual official bilateral creditors to be part of a group consensus, while reasonably protecting their interests, thus reducing the risk that the Fund could not assist a member in need because certain official bilateral creditors are seeking favorable treatment of their claims at the expense of other contributing official creditors.

Figure 4. Illustration of Main Elements of Staff's Proposed Lending-Into-Official-Arrears Policy



IV. NEXT STEPS AND ISSUES FOR DISCUSSION

24. If the Board supports the proposed modification, the new policy will apply immediately to all future Fund disbursements (including under existing arrangements), with respect to existing and future arrears. The current policy is described in a summing up and would be revised by a summing up.

25. Directors may wish to share their views on the following:

- Do Directors agree that the rapidly changing creditor landscape for official financing, especially the increasing share of non-Paris Club creditors, poses important challenges for the current policy on non-toleration of arrears owed to official bilateral creditors which has, thus far, relied heavily on Paris Club processes?
- Do Directors support staff's proposed modification to the arrears policy—namely, that in the absence of a Paris Club agreement that is sufficiently representative, or an agreement being reached with each creditor bilaterally or under alternative groupings, the Fund should be able to lend into arrears owed to an official bilateral creditor where all the conditions set out in paragraph 18 are satisfied?

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November 25, 2015

REFORMING THE FUND'S POLICY ON NON-TOLERATION OF ARREARS TO OFFICIAL CREDITORS—SUPPLEMENTARY INFORMATION

This supplement provides responses to issues Executive Directors raised during staff's outreach to them on the Board paper (Main Paper), and at the November 23, 2015 informal Board session.

A. Context and Motivation

1. The scope of the proposed reform is limited. It is important to recognize that the proposed modifications to the policy on non-toleration of arrears to official bilateral creditors ("non-toleration policy" or "NTP") are relevant only in situations where the Fund has already determined that a member country seeking financial support cannot address its balance of payments problems without a restructuring of its sovereign debt, and where that restructuring requires the participation of the country's sovereign creditors. The proposal does not, therefore, imply any increase in the frequency with which official bilateral creditors may be called upon to restructure their claims in future cases. Rather, the reform is aimed at ensuring that, where a restructuring is already determined to be necessary, the provision of Fund support is not held up by the unwillingness of hold-out creditors to join an effort that is supported by an adequately representative group of creditors (as defined under the policy). Prompt provision of support maximizes the value of creditors' claims (or minimizes their losses). By contrast, if a Fund-supported program is blocked or delayed, the debtor's payment capacity is impaired and the payout to official bilateral creditors will be significantly reduced.

2. The proposed reform strengthens incentives for collective action and reduces the risk of holdout behavior by eliminating the potential veto enjoyed by individual official bilateral creditors over Fund lending decisions. Just as in the private sector context, there can be incentives for an official bilateral creditor to hold out from a collective agreement in the hope of getting paid out in full, at the expense of other creditors that are contributing to the financing of the Fund-supported program. The leverage of such holdout creditors is strengthened by their ability in certain cases to block Fund financing under the current NTP. The proposed policy framework seeks to reduce the ability of holdout creditors to undermine the objectives of the majority creditors. By eliminating a holdout creditor's veto power, incentives for holdout behavior either within or outside the Paris Club would be effectively removed so that Fund financing can proceed subject to the three criteria in the proposed policy (see Annex I, second para.).

3. The proposed reform, while strengthening incentives for collective action, also provides safeguards for official creditors. In particular the criteria on "debtor good faith" and "the Fund's ability to mobilize future financing" in the proposed policy provide safeguards for

official bilateral creditors in recognition of their critical role in international finance and crisis resolution. The “good faith” criterion is intended to ensure the debtor acts in good faith—both in process and substance—when interacting with creditors. The criterion related to “the Fund’s ability to mobilize future financing” is intended to guard against situations where lending into arrears may send an undue negative signal to official bilateral creditors as a group, given the specific circumstances of the case. The proposed articulation of the new policy—see Annex I—elaborates on both these safeguards.

B. Form of Board Decision

4. Staff is of the view that a summing up would be the best vehicle to articulate the Board’s decision regarding the proposed reform of the NTP. Use of a summing up would be in line with the form generally taken by previous decisions on the arrears policy. More generally, a summing up permits the Board’s decision to be framed by background, underlying motivation, and context that may prove useful for purposes of interpretation in future cases. Further, a summing up will be able to record consensus views among Directors while simultaneously taking account of any significant nuances of views that would be difficult to reflect in a formal decision. Based on extensive consultation with Directors, both bilaterally and in the informal session to engage, Annex I to this supplement sets forth a description of the policy proposal that, if approved, will serve as the core of the summing up.

C. Clarification of Operational Issues

Deletion of the second criterion (Main Paper, para. 18)

5. Following input from Executive Directors, staff has deleted the second criterion, as redundant, for two reasons. First, as noted by Executive Directors, if an agreement has been reached with each official bilateral creditor (whether bilaterally or under alternative groupings), the debtor would not be in arrears, so the question of lending into arrears to official bilateral creditors would not arise. Second, the absence of a representative Paris Club Agreed Minute is actually a pre-condition for the application of the criteria and so has been moved to the chapeau sentence of the second paragraph in Annex I.

Definition of “significant share” (Main Paper, para. 15)

6. This supplement clarifies that the concept of “significant share” requires that a creditor agreement must be “adequately representative” of the official bilateral creditor base. An agreement will be considered “adequately representative” when it covers a majority of total financing contributions from official bilateral creditors over the program period. These contributions would comprise, and be limited to, debt service claims falling due—which represent potential debt relief—and any new financing (e.g. loans, bond financing, guarantees, and grants) over and above the amount needed to service such claims. If, in a particular case, it is

evident that the program parameters require less than full rescheduling of debt service coming due during the program period, this calculation could be adjusted accordingly.

Application of policy in the absence of an adequately representative Paris Club agreement
(Main Paper, para. 18, bullet 2)

7. Where there is no adequately representative Paris Club agreement, arrears to non-Paris Club official bilateral creditors would no longer be ignored (“deemed resolved”).

Rather, the new policy would require the debtor to seek agreement with each of its official bilateral creditors, and in the absence of such agreement, the Fund would not be prepared to lend into arrears unless the criteria set forth in the new policy are satisfied. Agreements with each creditor could be sought bilaterally or in groupings (including ad hoc committees).

“Good faith” criterion (Main Paper, para. 18, bullet 3)

8. The Fund would consider, *inter alia*, the following elements relating to *process* and *terms offered* when assessing whether a debtor is acting in good faith:

- **Process:** Broadly analogous to the private-creditor context, the Fund would consider, *inter alia*, whether the debtor has engaged in a collaborative process with the creditor to reach agreement on contributions and has offered to engage in substantive dialogue. However, the debtor should be willing to engage with official creditors independently from private creditors. Engagement with official creditors could take place through the Paris Club, an alternative grouping, or bilaterally. The debtor should also provide the creditor with relevant information on a timely basis, while respecting the Fund’s policy on confidentiality of information.
- **Terms offered:** The terms offered to official bilateral creditors would be expected to be consistent with the parameters of the IMF-supported program, in particular those relating to financing and debt sustainability. 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.

Criterion relating to the impact on the Fund’s ability to mobilize official financing packages in future cases (Main Paper, para. 18, bullet 4)

9. The Executive Board would need to ensure that the Fund’s arrears policy remains consistent with the Fund’s role in preserving the stability of the global financial system. An important element of this is securing adequate and timely support from official bilateral creditors for Fund-supported programs. In assessing whether the decision to provide financing 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 providing financing despite arrears owed to an official bilateral creditor would send to official bilateral creditors as a group, given the specific

circumstances of the case. In particular, this criterion would not be met 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 from official bilateral creditors over the program period, as defined above. Some Directors have expressed a strong preference that the Board should retain a limited degree of flexibility in applying this aspect of the criterion. If the Board were to decide to adopt such an approach, one option would be to insert the word “normally”, as shown in the relevant text of Annex 1 (3rd paragraph).

10. Separately, an assessment of whether this criterion is satisfied would also take into consideration the reliability of the creditor’s provision of support in past debt restructurings under Fund-supported programs, even if the creditor does not account for an adequately representative share of total financing contributions.

Annex I. Description of Proposed Policy

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 nonparticipating 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.

In circumstances where an adequately representative agreement has not been reached through the Paris Club, the Fund would consider lending into arrears owed to an official bilateral creditor only in 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;
- 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 covers a majority of total financing contributions from official bilateral creditors over the program period. These contributions would comprise, and be limited to, debt service claims falling due—which represent potential debt relief—and any new financing (e.g. loans, bond financing, guarantees and grants) over and above the amount needed to service such claims. If, in a particular case, it is evident that the program parameters require less than full rescheduling of debt service coming due during the program period, this calculation could be adjusted accordingly.

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; 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.

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 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 reliability of the creditor's provision of support 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.

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 or the Rapid Financing Instrument 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 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 policy will enter into effect immediately and will apply not only to Fund financing under existing Fund arrangements but also to future financing requests. Further, 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 to determine whether this policy continues to be met for the further use of the Fund's resources in the member's circumstances.



December 7, 2015

REFORMING THE FUND'S POLICY ON NON-TOLERATION OF ARREARS TO OFFICIAL CREDITORS—ADDITIONAL SUPPLEMENTARY INFORMATION

In response to questions raised by some Executive Directors, this second supplement clarifies the definition of “financing contributions” by official bilateral creditors, originally discussed in paragraph 6 and Annex I of Supplement 1, issued on November 25, 2015.

Rationale for the change

In light of questions received from Executive Directors, staff has concluded that the original language¹ used to define financing contributions (such as in Paragraph 3 of Annex 1 of Supplement 1) was unnecessarily complex. The new language below captures the intended concept in simpler and clearer terms.

Proposed language

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

¹ “First, an agreement will be considered “adequately representative” when it covers a majority of total financing contributions from official bilateral creditors over the program period. These contributions would comprise, and be limited to, debt service claims falling due—which represent potential debt relief—and any new financing (e.g. loans, bond financing, guarantees and grants) over and above the amount needed to service such claims. If, in a particular case, it is evident that the program parameters require less than full rescheduling of debt service coming due during the program period, this calculation could be adjusted accordingly.”



INTERNATIONAL MONETARY FUND



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Washington, D.C. 20431 USA

IMF Executive Board Discusses Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors

On December 8, 2015, the Executive Board of the International Monetary Fund (IMF) discussed the staff paper “Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors” and the supplementary information issued prior to the Board meeting, which amended and clarified the staff’s initial proposal.

The staff paper follows up on the Executive Board’s guidance to Fund staff in May 2013, which stemmed from an earlier staff paper: “Sovereign Debt Restructurings—Recent Developments and Implications for the Fund’s Legal and Policy Framework.” That paper reviewed the recent application of Fund policies and practices on sovereign debt restructuring and identified a number of issues for further in-depth study. The Executive Board agreed in May 2013 that these issues required follow-up work and asked staff to present options for reforming the Fund’s policy framework in each of the following areas: (i) the relationship between the Fund’s lending framework and sovereign debt vulnerabilities; (ii) the effectiveness of the contractual, market-based approach to debt restructuring in overcoming collective action problems; (iii) the framework for official sector involvement; and (iv) issues related to private sector involvement in debt restructurings including the lending-into-arrears policy.

The latest staff paper focuses on the Fund’s policy on official sector involvement, proposing a reform of the Fund’s policy on non-toleration of arrears owed to official bilateral creditors which Fund staff has advocated for since 1989. This proposal aims to strengthen incentives for collective action among official bilateral creditors when official sector involvement in a debt restructuring is necessary. The proposal envisages a two-step process, whereby the Fund would first encourage the debtor and its creditors to reach a representative collective agreement or, failing that, agreements with each creditor. If, after this process has run its course, there remain creditors who are unwilling to reach an agreement with the debtor and do not consent to Fund financing despite arrears owed, the Fund would nevertheless consider lending into arrears owed to official bilateral creditors where specific criteria were satisfied.

Importantly, the policy will provide appropriate safeguards for official bilateral creditors, as any decision to lend into arrears will be subject to the debtor's good faith efforts to reach agreement with its creditors, will be applied in a way that preserves the Fund's ability to mobilize official financing packages in the future, and will be subject to the Executive Board's approval, case by case.

Executive Board Assessment¹

Executive Directors welcomed today's discussion of proposed reforms to the Fund's policy on non-toleration of arrears to official bilateral creditors, one of the issues under the sovereign debt restructuring work program that was endorsed by the Executive Board in May 2013. They reiterated that the other three work streams—reforming the Fund's lending framework, strengthening the contractual approach to address collective action problems, and reviewing the Fund's lending-into-arrears policy—also remain critical to facilitate timely and orderly sovereign debt restructurings where these are necessary, thereby minimizing the associated costs for debtors, creditors, and the international financial system.

Directors noted that the changing landscape for official finance warrants a review of the Fund's policy on non-toleration of arrears to ensure that, where a restructuring is deemed necessary, collective action among official bilateral creditors is encouraged and the provision of Fund support is not held up by the unwillingness of hold-out creditors to join an effort that is supported by an adequately representative group of creditors. Directors recognized that prompt provision of support maximizes the value of creditors' claims (or minimizes their losses) and maintains the debtor's capacity to service its debt. They underscored that the reform proposal does not alter the current practices whereby the terms of debt treatment offered to official bilateral creditors have typically been more favorable than those received by private creditors. They also stressed that the proposal does not imply any increase in the frequency with which official bilateral creditors may be called upon to restructure their claims in future cases.

Directors highlighted that the financing that official bilateral creditors provide during crises is often critical for the success of Fund-supported programs. They emphasized, therefore, the importance of minimizing instances of arrears to official bilateral creditors. They concurred that any decision to provide financing despite the arrears should be based on a determination that it would not have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases. Directors underlined the need to strike an appropriate balance between the Fund's ability to provide timely support while maintaining important safeguards for official bilateral creditors.

¹ An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

In light of the above considerations, nearly all Directors endorsed the following revision to the policy on non-toleration of arrears to official bilateral creditors:

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.

In circumstances where an adequately representative agreement has not been reached through the Paris Club, 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.

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 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 policy will enter into effect immediately and will apply to all future purchases or disbursements (including under existing arrangements), with respect to existing and future arrears. Further, 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.

In supporting the reform proposal, many Directors expressed the view that it would be important to preserve comparability of treatment across official creditors. Some Directors also stressed that Fund financing in emergency cases under the RCF or the RFI without an assessment of whether the three criteria have been satisfied is expected to be rare and limited to a small sub-set of cases.

Notwithstanding their general support of the proposal, a few Directors expressed some reservations about the term "normally" used in the third criterion above, noting the risk that it may be applied in a manner that is not consistent with the principle of uniformity of treatment. In this regard, Directors agreed that any evaluation of this criterion in these abnormal circumstances should be in line with the Fund's mandate and based exclusively on a determination as to whether the Fund's decision to provide financing despite the arrears would have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases.

A few Directors raised concerns that the reform may not provide adequate protection to official bilateral creditors vis-à-vis private creditors. Directors were generally satisfied, however, that the policy preserves important differential safeguards for official bilateral creditors, including the requirement that the third criterion be satisfied.

Directors agreed that, given the importance of this policy change, and depending on the complexity and number of cases that arise, the policy may need to be reviewed within a relatively short period, namely, two to three years.