

Preface

This paper was prepared by the staff of the International Monetary Fund, for consideration by the IMF's Executive Board in an informal seminar in the context of its work on involving the private sector in the resolution of financial crises—the treatment of the claims of private sector and Paris Club creditors. The views expressed in the paper are those of the IMF staff and should not be attributed to Executive Directors or to their national authorities. The Board's views of this topic, as expressed at an informal meeting on August 23, 2001, at which the staff paper was discussed, are highlighted in Appendix II.

The paper was prepared by staff from the Policy Development and Review Department under the direction of Jack Boorman, Director, and Mark Allen, Deputy Director. The primary contributor was Matthew Fisher (Assistant Director of the Capital Account Issues Division, Policy Development and Review Department (PDR)).

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INTERNATIONAL MONETARY FUND

**Involving the Private Sector in the Resolution of Financial Crises—The Treatment of the
Claims of Private Sector and Paris Club Creditors—Preliminary Considerations**

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I. INTRODUCTION

1. This paper is a first step toward responding to a request from the Fund's Executive Board for consideration of issues relating to comparability of treatment between Paris Club and private sector claims in the exceptional cases in which a rescheduling by Paris Club and other official bilateral creditors is required.¹ Since the subject is both complex and controversial, the note only seeks to identify issues that warrant consideration and to provide a contribution to ongoing discussions. It does not offer concrete recommendations.

2. This paper attempts to place the discussion of comparability of treatment in the broader context of the involvement of the private sector in the resolution of financial crises and the Prague Framework. In practice, it is not possible to go beyond a general discussion without giving consideration to the details of Paris Club operations and the differences in the instruments available to official bilateral and private creditors. Accordingly, the paper provides a discussion of a number of key technical issues that arise in the context of the assessment of comparability. Staff believes that it would be useful to surface these issues and to hear the views of the Executive Directors. These will help guide the staff in future discussions with the Paris Club.

3. All Paris Club agreements include a clause under which the debtor country agrees to seek at least comparable terms to those obtained in the Paris Club rescheduling from other non-multilateral creditors and not to grant such creditors a treatment more favorable than given to Paris Club creditors.² This requirement reflects a need to ensure that support provided by Paris Club creditors for members' adjustment programs is not used to allow other creditors to exit, and to ensure a broadly equitable sharing of the financial burden of resolving financial crises between Paris Club and other creditors, bilateral or private. The assessment of comparability of treatment is the exclusive responsibility of the Paris Club.

4. Recent cases (notably Pakistan and Ecuador) have given rise to considerable debate among both private creditors and the official community concerning the application of the comparability provision in the context of developments in international capital markets in which international bonds have replaced syndicated bank credit as the primary vehicle for the extension of cross-border private financial credits to emerging market sovereigns. The move toward greater transparency on the part of the Paris Club will subject the Club's operations to

¹ This discussion is limited to comparability of treatment for countries receiving nonconcessional assistance. Issues associated with comparability of treatment for members benefiting from concessional Paris Club reschedulings and/or the HIPC initiative are beyond the scope of this note.

² The practice was established in the first Paris Club rescheduling agreement in 1956.

greater public scrutiny.³ Accordingly, this is an opportunity to step back and reconsider issues concerning comparability of treatment between official and private creditors.

5. Providing greater clarity to private investors concerning the circumstances in which the Paris Club would require the debtor to take comparable action toward its private creditors, and the ways in which comparability would be assessed in individual cases, could contribute to the efficiency of international capital markets. In particular, greater predictability could help facilitate investors' assessment, pricing, and management of risks. This, in turn, could contribute to improving the efficiency of the allocation of capital.

6. This paper is organized as follows. Section II provides an overview of policies concerning the financing of Fund arrangements (including the involvement of the private sector in the resolution of financial crises) and the circumstances in which restructuring by Paris Club and private sector creditors may be required. Section III provides a brief discussion of the implications for debt restructuring of developments in international capital markets since the 1980s. Section IV discusses some general issues that arise when assessing the comparability between restructurings by Paris Club and private creditors. This paper is limited to discussion of a number of key conceptual issues; other issues, including appropriate techniques for numerical calculation (such as the choice of discount rates and measures of duration) could be subject to later consideration.

II. GENERAL CONSIDERATIONS

A. Fund Policies Concerning the Financing of Arrangements

7. The Fund's interest in Paris Club reschedulings and comparability of treatment stems from their role in the financing of Fund-supported programs.

8. Fund-supported programs are intended to promote effective balance of payments adjustment and to help pave the way toward a return to balance of payments viability and sustainable growth. While some Fund arrangements do not entail the disbursement of financial support from the official community and serve to provide a signal concerning the quality of the authorities' policy framework, most entail the provision of exceptional financing⁴ from some combination of IFIs and official bilateral creditors. As discussed below,

³ The Paris Club has recently launched a website that provides extensive information concerning the Club's policies, procedures, and operations (www.clubdeParis.org). This is likely to increase the private sector's understanding of the Club's operations.

⁴ In accordance with the Balance of Payments Manual, Fifth Edition, the term exceptional financing is used to denote any arrangements to provide balance of payments financing, other than through the accumulation of reserve liabilities. It includes transactions related to debt

(continued...)

as a condition for the availability of its resources, the official community will typically require that there be a reasonable expectation that private creditors will also make an appropriate contribution to the financing of a program.

9. Financing packages supporting Fund arrangements need to ensure that programs are fully financed on terms consistent with a return to medium-term viability. Accordingly, there is a need to ensure that financing packages provide adequate cash-flow support during the program period, and also have repayment terms that are consistent with the prospects for the member's medium-term balance of payments. Such a financing package may require a restructuring of existing claims, and in some cases, a reduction in their contractual value. (Notwithstanding the general requirement that programs be fully financed, it may on occasion be appropriate for the Fund to provide early support for a member's adjustment efforts ahead of agreement with private creditors on a restructuring by "lending into arrears," as was done in the case of Ecuador). In such cases, part of the immediate cash-flow support comes from the accumulation of arrears.

B. The Involvement of Paris Club Creditors in the Resolution of Financial Crises

10. Fund arrangements typically include balance of payments supported with exceptional financing from Paris Club and other official bilateral creditors only in cases in which program-financing needs are large (in relation to the members quota), and the member's payments obligations to such creditors (in respect of the settlement of arrears and/or payment of current maturities during the program period) are substantial. In such circumstances, official bilateral creditors generally provide support through the rescheduling of existing obligations under the auspices of the Paris Club. Paris Club creditors as such generally do not provide exceptional financing through the disbursements of new money that can be used for balance of payments support, including meeting existing obligations. Nor do they offer liability management operations that can allow debtors to reprofile debt-service obligations outside the formal Club restructuring context.⁵

reorganization—such as rescheduling of existing debt and accumulation of payments arrears. For further details, see *Balance of Payments Manual, Fifth Edition* (1993), paragraphs 451–453.

⁵ In these respects, Paris Club creditors have a narrower range of instruments than the private sector. For countries that have retained market access, private creditors may be willing both to extend new financing and to participate in voluntary market-based operations designed to reprofile debt-service obligations, thereby avoiding the need for a concerted restructuring. By way of example, Argentina successfully arranged a swap to reprofile principal and partially capitalize interest on over \$29 billion of securitized debt.

Advance consultation between Fund staff and the Paris Club

11. In the exceptional cases in which financing packages require the participation of Paris Club creditors, there is normally advance consultation between Fund staff and these creditors, including during the negotiation of a program. Such consultations help ensure a common understanding of the financing requirements, on the one hand, and the conditions under which creditors would be willing to extend relief, on the other. The need for a common understanding covers both the scale of relief that could be granted by Paris Club creditors and specific requirements concerning the comparable treatment of the claims of other creditors so as to ensure coherence in the design of financing packages.

Paris Club Comparability of Treatment Requirement

12. A summary of Paris Club policies and procedures is provided in Box 1.

Box 1. Paris Club Debt Reschedulings for Middle-Income Countries

The role of the Paris Club

The Paris Club is an informal group of creditor governments that meets regularly in Paris to reschedule official bilateral debt as part of the international support provided to a country that is facing debt-servicing difficulties. The 19 permanent members are mainly OECD countries, but other creditors can participate in specific reschedulings.

Paris Club creditors agree in a multilateral framework with debtor countries on the terms and coverage of a rescheduling, which vary according to the debtor countries' financing needs and income level. The Club works on the basis of consensus and solidarity among creditors: no decision can be reached in the Paris Club unless it is accepted by all participating creditor countries, and no participating creditor will seek better treatment from a debtor country than that available to other Paris Club creditors. Terms and coverage of a rescheduling are negotiated on a case-by-case basis.

Relation with Fund Arrangements. There is a close relation between Fund arrangements and Paris Club reschedulings. The Paris Club will only consider a rescheduling with countries that are in a program supported by an upper credit tranche arrangement with the Fund.

Terms for middle-income countries

Standard rescheduling terms are 10-years maturity, including 3 years grace, but the terms applied in the last few years have been more flexible.

Lower middle-income countries usually receive Houston terms: for commercial debt, a graduated repayment schedule with up to 18 years maturity, normally including 3 years grace, and market interest rates; and 20 years maturity, including up to 10 years grace for ODA debt at interest rates at least as concessional as the rates applying to the original credits. Eligibility for Houston terms is guided by both income and debt burden criteria, based on World Bank data. Since the beginning of the 1990s, *upper middle-income countries* have increasingly received terms close to Houston terms.

Box 1 (concluded). Paris Club Debt Reschedulings for Middle-Income Countries

Coverage of reschedulings

Debt service that is eligible for rescheduling generally comprises arrears (principal, interest, late interest) and maturities (principal and interest) falling due during an agreed period of time (the consolidation period) on medium- and long-term sovereign or sovereign-guaranteed debt contracted before a cutoff date, usually specified in the debtor's first Paris Club agreement. The consolidation period typically coincides with the time span of the debtor's arrangement with the Fund. Coverage under a Paris Club rescheduling, i.e., what debt service or arrears are rescheduled, depends on the financing need as shown in the program. To protect new financing by official creditors against rescheduling, post-cutoff date and short-term debt are not rescheduled. In cases of exceptional financing needs, however, arrears on these categories of debt may be deferred over shorter periods of time.

Flow Versus Stock-of-Debt Rescheduling

Paris Club reschedulings for middle-income countries have mostly been in the form of flow reschedulings. A few reschedulings have included a treatment of the stock of debt, such as the agreements with Poland (1991) and Egypt (1994), and to a more limited extent, Russia and Peru (1996).

13. All Paris Club agreements contain a clause under which the debtor country agrees to seek at least comparable terms to those obtained in the Paris Club rescheduling from other creditors and not to grant to other creditors a treatment more favorable than to Paris Club creditors.⁶ This general policy is understood to apply to all creditors, with the exception of multilateral institutions, whose preferred creditor status has long been accepted by Paris Club creditors (on the basis that multilaterals typically provide net new money and will typically at least maintain, and may possibly increase, their exposure during a crisis). In assessing whether action taken by nonparticipating creditors is comparable to their own action, Paris Club creditors have not been concerned with the precise form that the debt restructuring takes, but rather with the effective relief provided in cash flow and present value terms, as well as the maturities of the restructured claims as measured by duration (as discussed below).⁷ Paris Club creditors also take into account whether a nonparticipating creditor is providing new money. Comparability of treatment is assessed on a case-by-case basis.

14. There are a number of rationales for the comparability provision.

- *First*, while the official bilateral creditors are generally willing to provide exceptional financing to support members' adjustment efforts, they are not willing to provide new financing, or to exercise forbearance, in a fashion that allows other creditor groups to

⁶ See Appendix I.

⁷ Duration provides a discounted-weighted average maturity of payments falling due on a debt instrument. It is, in effect, the average maturity of the present value of the payment stream.

unwind their exposure. This is intended to protect official bilateral creditors' financial interests. Moreover, it is unlikely that practices that lead to the costs of resolving crises being borne disproportionately by taxpayers would be politically tenable. Accordingly, in order to provide the Fund with the financing assurance needed to provide adequate safeguards for the use of its resources, it will typically be necessary to ensure broadly equitable burden sharing between private and official creditors in the resolution of financial crises on account of the limitations on the availability of Fund financing, and the requirements of comparability attached to the provision of financing by official bilateral creditors.

- *Second*, the official community is concerned that the treatment of private sector claims could have important implications for the efficient operations of capital markets. Specifically, there is a concern that a willingness by the official community to extend exceptional financing on a scale that would, in effect, shelter private creditors from market risk and give private creditors a free pass on contributing to the resolution of crises could give rise to *moral hazard*; thereby potentially increasing both the severity and frequency of future crises.⁸ By the same token, it is recognized that the design of financing packages that are perceived in financial markets as making the claims of private creditors junior to those of official bilateral creditors could have important implications for volume and composition of private flows to emerging markets (Box 2).

⁸ The Paris Club's policy of maintaining a fixed cutoff date, thereby protecting new creditors from any potential restructuring, is also a potential source of creditor moral hazard to the extent that it reduces incentives for the careful scrutiny of the quality of new credits. On the other hand, the maintenance of fixed cutoff dates has provided a basis for export-credit agencies (and bilateral creditors more generally) to extend new financing to countries that are expected to have ongoing need to seek relief from Paris Club creditors.

Box 2. Impact of the Design of Financing Packages on the Composition of New Private Capital Flows

When private investors extend credit, or purchase credit in secondary markets, they will evaluate, inter alia, the recovery value of their claims in the event that they need to be restructured. One critical aspect of this evaluation concerns the relative seniority of the claims of private creditors compared to the seniority of the claims of other types of creditors.

The experience of recent years provides instances in which the claims of bondholders have been *de facto*:

- *Senior to claims of Paris Club creditors with respect to liquidity risk* For instance, in two cases in which members did not service all of their claims (Ecuador and Nigeria), the claims of private creditors continued to be serviced during sustained periods in which arrears were accumulated to Paris Club creditors.
- *Junior to Paris Club creditors with respect to solvency risk* For instance, in the context of Brady deals, the official community encouraged the member to reach an agreement with its private creditors that featured debt and debt-service reduction (DDSR), while the Paris Club creditors were not willing to go beyond (nonconcessional) Houston terms.

It is clearly difficult to quantify the impact on the availability of new capital flows of the market perception of the relative seniority of international bonds, *vis-à-vis* claims of Paris Club creditors. Nevertheless, a perception of a relative seniority that forces private creditors to bear a disproportionate part of the risk associated with resolving solvency problems could reduce the willingness of investors to extend new credit. This effect could be amplified by the difficulty faced by managers of investment funds in diversifying risk. (Three sovereigns—Argentina, Brazil, and Mexico—account for over 60 percent of the EMBI (a standard index used to compare the performance of fund managers)). But it could be mitigated by relative seniority with respect to liquidity risk. If the net effect is that markets consider bonds junior to official bilateral claims, this will be reflected in some combination of: (i) reduced volume of private capital and higher interest rates; (ii) a shortening of maturities; and (iii) a shift in the form of capital toward instruments that are more difficult to restructure (these might include bonds supported by security packages (such as liens on receivables), and short-term interbank loans).

15. The rationale concerning equitable burden sharing in financing a country's adjustment program points to a number of different dimensions of comparability of treatment. The first concerns the (net) cash-flow relief provided during the program period. The second concerns the extension of maturities, that is to say the amortization profile on the restructured claims. The third concerns the interest burden associated with the restructured claims.

16. In the context of the 1980s debt crisis, comparable relief from their private creditors for countries seeking debt relief from Paris Club mainly affected commercial bank claims. In recent years, most of the countries that have sought relief from the Paris Club that had substantial liabilities to private creditors were low-income countries and comparable treatment issues have been resolved through buybacks at steep discounts financed, in part, by the IDA Debt Reduction Facility. However, there have been a few cases where comparable treatment from private creditors required a restructuring of their claims. These included Pakistan (international sovereign bonds, loans extended by commercial banks and foreign currency liabilities of commercial banks), Indonesia (syndicated bank loan), and Kenya

(medium-term trade credits extended by banks and suppliers). In the cases of Ecuador and Ukraine, the private restructurings were completed ahead of the Paris Club agreements.⁹

III. DEVELOPMENTS IN CAPITAL MARKETS SINCE THE RESOLUTION OF THE 1980S DEBT CRISIS

21. During the early phase of 1980s debt crisis, it was relatively straightforward to arrange for comparability of treatment between the restructuring of Paris Club claims and the claims of private creditors. The structure of private financing to emerging market economies in the 1970s and 1980s—primarily syndicated bank credits and short-term trade finance—facilitated restructurings by both creditor groups using broadly parallel structures. Both creditor groups were able to restructure principal maturing over a defined period and to restructure current interest (or in the case of banks, extend new financing broadly equivalent to current interest). Toward the end of the 1980s debt crisis, however, banks became increasingly reluctant to provide repeated flow reschedulings. Under the Brady initiative, banks restructured the stock of the claims in the form of bonds and in many cases sold their claims in the secondary market. (Banks exchanged their loans for a range of possible instruments selected from a menu that differed, inter alia, with regard to the extent of debt and debt-service reduction, and supporting principal and interest collateral.) The process of negotiating Brady deals was in many cases protracted, and Paris Club creditors provided flow reschedulings while some members were in sustained arrears to their private creditors.

22. The subsequent change in the operation of capital markets and the composition of private capital flows has substantially complicated the task of assessing and achieving comparability. In particular, investors in emerging market debt are no longer heavily concentrated among relatively homogeneous international banks, but instead consist of an increasingly diverse group of investors, including dedicated investors in the asset class, so-called crossover investors,¹⁰ pension funds, hedge funds, other investment companies, and the retail sector. At the same time, there has been a pronounced shift in the composition of private market financing for sovereigns—away from syndicated loans and toward internationally-traded bonds. (Such bonds may include both international and domestic issues.) Nevertheless, commercial banks remain an important source of financing,

⁹ See *Involving the Private Sector in Resolving Financial Crises—Restructuring International Sovereign Bonds* available at <http://www.imf.org/external/pubs/ft/series/03/index.htm>.

¹⁰ Crossover investors invest in a wide range of financial assets and are not dedicated to emerging market instruments. Nevertheless, they may move in and out of these investments in response to changing market conditions.

particularly for trade credit and projects. As a result of these changes, it is generally no longer possible to arrange the parallel flow restructurings by Paris Club creditors and foreign private sector creditors. In a nutshell:

- Recent experience suggests that bonds must be restructured through debt exchanges.¹¹ These are stock-of-debt operations, rather than flow reschedulings.¹² Securing high participation in the exchange requires the credible threat that bondholders who do not participate in the exchange will not be paid. At the same time, the success of debt exchanges requires an expectation that the new instruments would not be re-structured, at least in the context of the then current crisis.¹³ (Such an expectation provides investors with incentives to participate in debt reorganizations and to eschew litigation, as well as avoiding the debtor having to pay the fees and commissions associated with repeated restructurings.)
- In an environment of high capital mobility, the distinction between resident and nonresident investors, and domestic and international instruments, has in some cases become progressively less relevant.
- The focus of the Paris Club is on resolving external financing difficulties of the sovereign. Accordingly, Paris Club creditors' concerns relating to intercreditor equity tend to focus on other creditors with external claims. (In most cases, this will limit the need for a restructuring to international bonds. In some cases, however, nonresidents may have substantial holdings of domestic instruments, which could raise a question concerning their treatment in a concerted financing package.) Private creditors, in

¹¹ In principle, bonds that include collective action clauses could be restructured through the use of the contractual provisions allowing for the modification of repayment terms by creditors holding a qualified majority of principal. In practice, however, a debt exchange may be considered preferable to the use of collective action clauses, as occurred in Pakistan. For further details see *Involving the Private Sector in the Resolution of Financial Crises—Restructuring International Sovereign Bonds*.

¹² Contacts with private creditors and market commentaries indicate that to date, there has been no market appetite for coupon-only restructurings that would provide flow relief. Investors have indicated that stock-of-debt operations would tend to enhance the secondary market value of their claims, compared to a restructuring of the flow of coupons that leave the underlying instrument intact. Creditors have indicated that following a restructuring of coupons, the underlying instrument would be considered to be particularly vulnerable to further rescheduling, and would therefore trade at a discount.

¹³ This would preclude trying to replicate successive Paris Club flow reschedulings by successive private sector stock-of-debt operations.

contrast, tend to focus on broader intercreditor equity issues, including equity across domestic and international capital markets. Indeed, pressures within the private sector for intercreditor equity may make it difficult for a sovereign seeking a restructuring of its international bonds to avoid seeking in parallel a restructuring of its domestic debt.¹⁴ To the extent, however, that domestic banks have significant holdings of such instruments, a restructuring of domestic debt may have profound implications for both the solvency and liquidity of the domestic banking system, which could, in turn, contribute to economic dislocation and the fiscal cost of resolving banking sector difficulties. Accordingly, any restructuring of sovereign's domestic debt instruments needs to be closely coordinated with broader efforts to stabilize and reform the financial system. This suggests that the precise application of the Paris Club's comparability provision would need to be considered on a case-by-case basis and could be very difficult.

23. The change in the composition of private creditors has had a number of effects on the incentives for private creditors to participate in the resolution of crises.

- The shift away from international banks as the primary source of cross-border financing to emerging market sovereigns has reduced the potential role of moral suasion in persuading creditors to participate in a debt restructuring.
- Some private investors (such as banks and suppliers) may have long-term commercial relationships with the debtor. Such investors may be willing to exercise forbearance during a crisis in order to preserve profit opportunities in later periods. Other investors (such as bondholders), however, may have no long-term commercial interests with the debtor and may take a somewhat more limited view of their financial interests.¹⁵
- In contrast to the experience in the 1980s debt crisis, sovereign claims are now traded extensively on secondary markets. In a number of recent cases, distressed, or near distressed, debt has been acquired by so-called "vulture" creditors who specialize in extracting salvage value through litigation. While litigation is expensive, and the

¹⁴ Investors holding international instruments may be unwilling to exercise forbearance, and possibly accept losses, if this is seen as allowing investors holding domestic instruments to remain whole and to exit early.

¹⁵ Although bondholders as a group may benefit from debt reorganizations that help to preserve the value of their claims on the debtor concerned (and the value of the asset class more generally), there are likely to be substantial difficulties in resolving collective action difficulties needed to persuade individual bondholders to participate in reorganizations on a voluntary basis.

results are subject to substantial uncertainty, it has been used successfully by some creditors obtain settlements at face value (e.g., Peru) or on terms significantly more favorable to private creditors than those extended by Paris Club creditors.¹⁶

24. Most bondholders are now required to value their portfolios in line with prices prevailing in secondary markets (mark-to-market). This forces them to recognize any losses in the secondary market value of their claims, and provides strong incentives to participate in operations that offer the prospect of immediate capital gains.¹⁷ This has introduced a difference of viewpoint among private creditors, official creditors, and the debtor.

- The primary concern of private creditors is with the secondary market value of their claims.
- Official creditors, in contrast, place more emphasis on the face value of their claims and with the debtor's debt-service profile. That is to say, official creditors expect to be repaid in full and tend to assume for budgetary purposes that the interest rate received on nonconcessional reschedulings is an appropriate return, which in turn requires that programs are fully financed and that the member is moving toward medium-term sustainability.¹⁸
- The debtor, however, will typically be concerned with both the face *and* the secondary market value of its claims, as well as the payments profile. The concern about the face value of the debt stems from the expectation that debts must be repaid, while the concern about the secondary market valuation reflects a concern about markets' assessment of the country-risk premium, which will be an important determinant of the ability of the debtor to regain spontaneous market access, and to bring down domestic interest rates.

25. The differences between the perspectives of private and official creditors may provide some scope for flexibility in developing proposals for the restructuring of debt, as discussed below.

¹⁶ See *Involving the Private Sector in Resolving Financial Crises—Restructuring International Sovereign Bonds*, EBS/01/03 (1/11/01).

¹⁷ In contrast, during the early part of the 1980s debt crisis some banks did not recognize losses and were reluctant to participate in restructurings that would have forced such a recognition, even if it could have increased the economic value of their claims.

¹⁸ It is possible that the gradual evolution of the approaches to public accounts will over time make the possibility that loans will not be repaid in full more transparent, thereby moving public accounts toward a mark-to-market basis.

IV. ISSUES CONCERNING THE ASSESSMENT OF COMPARABILITY

26. Individual reschedulings are likely to highlight a number of practical issues concerning the ways in which comparability of treatment is interpreted. The diversity of the circumstances facing individual debtors may make it difficult to establish a hard-and-fast rules-based system for assessing comparability. Notwithstanding the need to retain some degree of flexibility in the handling of individual cases, however, there would be merit from the perspective of reducing market uncertainties in establishing—and making transparent—certain practices which are likely to guide future agreements with individual debtors. Accordingly, consideration could be given to adopting relatively simple and straightforward practices that are perceived as being generally fair. The rest of this section provides a preliminary discussion of the issues associated with assessing comparability in cases in which the claims of private creditors are to be restructured. It raises for discussion a number of possible approaches, but does not make concrete recommendations. While most of the discussion concerns cases in which there is only one type of foreign private creditor (holders of international sovereign bonds), the section includes a brief discussion of cases in which there is a diversity of private sector instruments that must be captured in a restructuring.

A. Treatment of Private Sector Stock-of-Debt Operations vs. Paris Club Flow Restructurings

27. As noted above, the restructuring of bonds tends to take the form of stock-of-debt operations, in which existing instruments are exchanged for new instruments.¹⁹ The Paris Club, meanwhile, continues to provide flow reschedulings. In some cases, this may make little difference as all (or at least much) of the private sector's principal may fall due within the Club's consolidation period (as was the case in Pakistan in which bonds and syndicated loans had short residual maturities). In other cases, however, maturities to private creditors may be predominantly interest (i.e., coupon payments) with principal payments scheduled for several years after the end of the consolidation period (Ecuador²⁰). If the Paris Club maintains

¹⁹ With the declining importance of syndicated loans as a vehicle for lending to emerging market sovereigns, commercial bank claims tend to consist predominantly of relatively short-term trade and financial credits, which would mature within the consolidation period and so require a stock treatment in cases in which they need to be restructured. Normally, however, such short-term claims would be outside the scope of a Paris Club restructuring. In most cases, it would be expected that short-term claims would not be covered by a restructuring but could be covered by a (typically voluntary) rollover agreement.

²⁰ In the case of Ecuador, the distinction between maturities of principal and coupons was blurred by the decision of investors holding discount bonds to accelerate their claims, thereby making the full amount of principal immediately due and payable. In practice, official bilateral creditors have not exercised any rights they may have had to accelerate their claims.

its practice of repeated flow restructurings, how should private sector stock-of-debt and Paris Club flow rescheduling be compared? It may be helpful to consider this in a number of steps.

How to treat possible future Paris Club restructurings²¹

28. One approach would be to compare the extension of maturities by the private sector under stock-of-debt operations and the outcome under a single flow rescheduling by the Paris Club. This was the approach adopted in the case of Pakistan. This would seem to provide a reasonable basis for assessing comparability of treatment in circumstances in which the member is not expected to require a sequence of back-to-back flow restructurings. In cases in which the balance of payments projections supporting a member's request for the use of Fund resources point to the need for relief from Paris Club creditors being sustained over a number of years, however, such a limited comparison could be misleading and unduly favorable to the private sector.

29. An alternative approach that could be applied in such cases would be to compare on an "as if" basis—as if the Paris Club's immediate and prospective restructurings were consolidated into a single operation. That is to say, a comparison could be drawn between the maturities of the private sector's claims following a stock-of-debt restructuring, and the maturities that Paris Club creditors would have after taking account of the impact on maturities of both the initial Paris Club flow consolidation *and* probable future consolidations. This would give recognition to the likelihood that the forbearance required by Paris Club creditors, although tranching, will extend beyond that associated with a single flow restructuring. This may require an implicit Paris Club undertaking beyond the goodwill clause that would signal official creditors' willingness to consider a number of successive requests for debt relief.

Should comparisons be made using the stock of Paris Club pre-cutoff date debt, or the stock of restructured maturities?

30. If Paris Club restructurings are viewed as being on an as if basis, there is a question concerning whether comparisons should be drawn on the basis of the total stock of the Paris Club's pre-cutoff date claims (including previously rescheduled debt), or whether the calculation should be limited to the actual maturities of principal and interest captured in the actual and as if restructurings. As private creditors would have potentially modified all their scheduled payments by virtue of the stock-of-debt operation, it would seem appropriate to compare the private sector operation with the impact of the Paris Club rescheduling on the total stock of official creditors' pre-cutoff date claims. (Issues concerning the treatment of post-cutoff date debt are discussed separately, below.)

²¹ As noted above, a discussion of the measures of maturities and their calculation is beyond the scope of this note, and could be addressed in a future note.

Coverage by type of claim

31. As regards the coverage by type of claim, it would seem reasonable to exclude types of credits that neither group of creditors has included in restructurings. For example, if neither Paris Club nor private sector creditors have included short-term claims (including financial credits and trade-related claims), then these should be excluded from the calculations concerning comparability of maturities.

B. Cutoff Date

32. The Paris Club policy of maintaining fixed cutoff dates in restructurings has provided a basis for the extension of new credits to countries that have restructured debts and are implementing appropriate policies. The subordination of “old” money to “new” money provides an assurance that new credits will not be captured in subsequent restructurings. There are questions as to whether similar treatment should be extended to private credit contracted after the cutoff date, and how post-cutoff date claims of Paris Club creditors should be treated in the context of an assessment of comparability.

33. In practice, there are significant impediments to achieving a comparable subordination strategy among private creditors. Contractual provisions (cross-default and cross-acceleration clauses) provide contractual links between debts that generally preclude the subordination of old debts to new debts. Indeed, they are designed to preclude such a subordination in order to avoid the moral hazard of encouraging borrowers to raise borrowing to unsustainable levels by promising new lenders seniority over old ones. As a result, at the time that investors extended new credits, there could have been no expectations that the new claims would be protected from a restructuring, and they would have been priced accordingly.²²

34. Regarding the treatment of post-cutoff date debt for the purposes of assessing comparability, there would appear to be two principal options.

- The first would treat post-cutoff date Paris Club debt as senior to all other claims of official bilateral and private creditors. Under this approach, the debtor would be required to seek comparability between restructured Paris Club claims and all private debt. Clearly, there would be a question under this treatment of the likely reaction of private capital markets and specifically, whether the *de facto* subordination of private claims to the post-cutoff date claims of official bilateral creditors would tend to raise the cost and reduce the quantity of new private financing.

²² In the recent case of Ecuador, following the default on the Brady bonds, the authorities initially indicated their intention not to restructure the Eurobonds. In the event, however, investors insisted that Eurobonds be brought within the scope of the restructuring.

- A second approach would treat post-cutoff date debt as an intra-Paris Club creditor issue. Under this approach, a debtor would seek comparability between the treatment of private claims and the average treatment given to pre- and post-cutoff date claims of Paris Club creditors. This would tend to produce a more level playing field between new official credits and new private sector credits.
- A third approach would be to attempt to provide contractually at the time of rescheduling for the explicit seniority of a certain amount of post-cutoff private sector debt, thus overriding the normal sorts of cross-default and cross-acceleration clauses for this specific set of assets. In absence of a sovereign bankruptcy mechanism that could provide a mechanism for imposing a modification of existing debt contracts, however, this seems unlikely to be feasible.

C. Basis for Comparing Impact of Debt Restructurings on Maturities

35. In practice, restructurings may cover claims of differing maturities, with one creditor group holding predominantly long-term instruments while creditor groups hold relatively short-term instruments. In such cases, a question that would arise is whether comparisons would be made between *changes* in maturities as a result of restructurings, or on the basis of the *actual* maturities following restructurings. The former would equalize the degree of creditor forbearance associated with the restructuring and tend to preserve the initial relative maturity of creditors' claims. The latter would produce broad equality between the maturities of different groups of creditors, ensuring that they get paid *pari passu*.

D. Payments to Creditors During the Program Period

36. In addition to assessing comparable coverage and maturities, there is a need to consider how to achieve comparability concerning debt service to be paid during the program period. For Paris Club creditors, such payments generally consist of moratorium interest, and possibly payments on arrears that need to be settled immediately or are to be cleared within the consolidation period. For private creditors, such payments typically consist of interest plus other payments made at the time of the bond exchange. (In the case of Ukraine, for example, investors received in cash interest that had accrued since the last coupon date. In the case of Pakistan, the Paris Club agreed to a payment of a put option on the remaining \$18 million of principal outstanding on a Eurobond maturing in 2000, as the amount was small, and it would have been difficult to have secured agreement on an early restructuring.)²³

²³ In the case of Ecuador, the Paris Club recognized that payments made to private creditors in respect of collateral associated with Brady bonds should be seen as stripping investors' country exposure from their U.S. exposure, rather than partial repayment of their claims on the debtor. (Such payments were financed by drawing on the collateral that had been held by the collateral agent.)

37. Two possible approaches to comparability have been suggested. First, linking payments to different creditor groups to creditors' overall exposure, and second, linking payments to different creditor groups to the scheduled payments falling due in the consolidation period and the settlement of arrears, if any.

- The former approach fits most comfortably with the private sector's stock-of-debt operations. As the restructured debt would typically take the form of restructured securities, from a private sector perspective it would be normal to relate cash payments to outstanding claims, rather than linking actual cash payments to payments scheduled under previous extinguished instruments.
- The latter approach, in contrast, fits most comfortably with traditional Paris Club procedures, under which moratorium interest is calculated on the basis of claims covered by a consolidation, rather than overall exposure.

E. Credit for Previous Operations

38. In cases in which private debts that have previously been restructured are to be included in restructurings, questions arise concerning the credit to be given for previous operations. This has been an issue in the restructuring of Brady bonds where, in the context of an earlier restructuring, creditors have granted debt and debt-service reduction. Private creditors holding instruments that were subject to an earlier round of debt and debt-service reduction argue that they should not be expected to provide a further round of debt reduction without corresponding action by other creditors (though their claims may have been acquired in the secondary market following the restructuring). A number of approaches to this issue could be considered.

39. A *first* approach would recognize previous relief granted by creditors, and ask such private creditors to grant further DDSR only after Paris Club creditors had granted debt reduction that was at least broadly comparable with the concessions earlier extended by these private creditors. Such an approach would raise a number of issues:

- The secondary market pricing presumably reflects the experience that, with rare exceptions (Egypt and Poland), the Paris Club extends concessional relief only to low-income countries. Private creditors participated in Brady deals with 18 countries. In all but two cases, the official community did not provide debt and debt-service reduction (DDSR). Arranging for any future Paris Club restructuring to provide an ex post catch up between the relief granted by Paris Club and private creditors would provide private investors with a windfall gain.

- It would be difficult to devise a fully satisfactory mechanism for comparing debt reduction by the Paris Club in the current period with the history of factors that have affected the value of private claims.²⁴

40. A *second* approach would be to treat a restructuring in the context of a new crisis in a fashion analogous to the treatment of claims on a nonsovereign borrower in the context of a bankruptcy. That is to say, a line would be drawn at the start of the then current crisis, and no account would be taken of any debt relief/reduction that may have been granted in previous restructurings.²⁵ However, account would be taken of previous restructurings that had occurred in the context of the then current crisis. (This would be important so as to avoid establishing incentives for creditors to delay reaching restructuring agreements simply in order to ensure that such agreements would be credited by the Paris Club in the context of the assessment of comparability.)

41. A *third* approach would represent a middle pragmatic position. On the one hand, as under the second approach, no account would be taken of DDSR granted by the private sector in the context of a previous crisis. On the other hand, it would be recognized that: (i) a previous restructuring had produced a substantial extension of maturities and flattening of the debt-service profile; and (ii) restructuring bonds is a costly and time-consuming process. This could lead to a presumption that Brady bonds would generally not need to be restructured in cases in which the Paris Club rescheduling is on nonconcessional terms. While this could provide a pragmatic compromise, two points warrant consideration. First, in cases of extreme liquidity crises, the magnitude of financing requirements might make the restructuring of Brady bonds inescapable. Second, in circumstances in which the member concerned decided to restructure other types of international bonds (such as Euros and Globals), private creditors may insist that Brady bonds be brought within the scope of a restructuring.²⁶

²⁴ In addition to issues associated with the analysis of the original Brady deal (including how to treat the official sector's contribution to the cost of financing, the acquisition of collateral, and the cost of debt reduction borne by the fiscal accounts through the tax treatment of banks' loan loss provisions), there would be a question of how to treat the provision of new financing by both private and official creditors *after* the conclusion of the Brady deal.

²⁵ Under this approach, there would be a contradiction between disregarding previous private sector restructurings while continuing the Paris Club practice of excluding at least some payments relating to previous Paris Club restructurings (previously restructured debt) from the scope of a restructuring.

²⁶ Such a position by private creditors might be motivated, *inter alia*, by some combination of the following factors: (i) intercreditor equity; (ii) the portfolio needs of creditors engaged in relative value (convergence trades) who would be concerned about the relative treatment of Brady *vs.* other international bonds; and (iii) investors concerned about the broader

(continued...)

F. Debt Reduction and Reverse Comparability

42. Private investors have called for reverse comparability. That is to say, they have called on debtors that have obtained debt and debt-service reduction from them to seek comparable reductions by Paris Club creditors.^{27 28} More generally, private investors have argued that in cases in which countries have an excessive debt burden, and need debt reduction in order to return to sustainable growth and medium-term viability, the burden of providing debt and debt-service reduction should be borne equitably by official bilateral and private creditors. Private creditors have argued that forcing the full burden of debt and debt-service reduction on to the backs of private creditors will have the effect of subordinating the claims of private creditors to those of official creditors, which will have adverse systemic effects on the willingness of the private sector to extend new financing to emerging market sovereigns.

43. The Paris Club has rejected calls for reverse comparability. As noted above, Paris Club policies generally limit debt and debt-service reduction to low-income countries. Bilateral creditors have argued that relief provided through the Paris Club is just one of a number of channels through which official support is provided to countries in crisis. (Other channels may include direct bilateral lending, official support for export credits, as well as the financial resources provided through the IMF, World Bank, and other IFIs.) Moreover, official bilateral creditors have argued that their policy of holding their claims to maturity—and generally eschewing trading claims in secondary markets—helps to preserve the secondary market value of private investors’ claims. (The securitization and secondary market sale—or even the prospect of such a sale—of the claims of official bilateral creditors could have substantial effects on the mark-to-market value of private investors claims, and the prospect for the debtor being able to regain spontaneous access to international capital markets.)

implications for the asset class of favoring Brady bonds in the event of a need for a private sector restructuring.

²⁷ See, for example, a recent paper entitled “Burden Sharing in 2001, Now is the Time to Reform the Paris Club” posted on the Emerging Market Traders Association (EMTA) website.

²⁸ This argument has been made in the context of Russia. Private creditors that accepted a reduction in principal have argued that Paris Club creditors should offer a comparable reduction in principal. It should be noted, however, that the restructuring of private claims (a re-restructuring of original London Club debt) provided for a change in the identity of the debtor from Vnesheconombank of the U.S.S.R. to the Russian Federation. It is thus difficult to disentangle the reduction in the contractual value of creditors’ claims from the increase in the quality of the claim.

44. A discussion of whether or not the Paris Club should consider a modification of its policies with regard to debt reduction for middle-income countries is beyond the scope of this note. Within the framework of the Club's current policies, however, there are two issues that warrant consideration. The first concerns the conceptual basis for assessing debt reduction, and the second concerns how to assess comparability in cases in which the private sector provides debt reduction and Paris Club creditors provide a nonconcessional restructuring.

How should debt reduction by private creditors be treated in assessing comparability?

45. Private investors generally point to the "haircut" as a measure of the debt reduction provided by a restructuring agreement. The haircut is calculated as the difference between the secondary market value of the restructured claim, and the face value of the original claim. (The secondary market value of the debt incorporates the country risk premium—the market assessment of possible losses associated with a failure of the debtor to honor debt-service obligations.) In some cases, haircuts have been associated with restructurings that preserve—or even increase—the net present value of the payment stream calculated at a suitable risk-free interest rate (Pakistan and Ukraine).²⁹ In other cases, the restructurings produced a reduction in the NPV of the debt (Ecuador and Russia).

46. The Paris Club, in contrast, generally measures debt concessions by comparing the face value of the debt with the NPV of payment obligations calculated using a near risk-free interest rate. Other than with low-income countries, Paris Club restructurings generally preserve the NPV of the claims. However, valuing restructured Paris Club claims at the secondary market yields which exist for private investors' claims would show that Paris Club creditors had also taken substantial haircuts.

47. As a result of these differences in measuring NPV, there may be approaches that can simultaneously satisfy the objectives of both types of creditor.³⁰ As noted above, private bondholders provide debt relief through stock-of-debt operations and assess proposed bond exchanges in terms of their impact on secondary market prices.³¹ Provided that a private

²⁹ Such as LIBOR, or the commercial interest reference rate (CIRR) used by export credit agencies.

³⁰ A discussion of the discount rate that the public sector of the debtor should use in appraising the net present value of future cash flows is beyond the scope of this paper.

³¹ For a given country risk premium, an extension of maturities at interest rates below the secondary market yield will decrease the secondary market value of investors' claims. A restructuring that is seen by markets as alleviating a liquidity crisis can be expected to reduce the country risk premium, however, and will tend to increase the secondary market value of investors' claims. Actual price movements will reflect the net effect of these two opposing factors.

sector restructuring is accompanied by a sufficiently large decline in secondary market yields, it may be possible to engineer an exchange that achieves comparable extension of maturities to that provided by Paris Club creditors, and offers investors the prospect of a capital gain.³² Moreover, the differences in the discount rates used by the private sector to value future debt-service payments (secondary market yields) and official bilateral creditors (a near risk-free interest rate) opens the way for the private sector to provide debt reduction through a reduction in the face value of debt-service payments in exchange for a shortening of maturities. This raises a question of whether in assessing comparability, Paris Club creditors should be willing to consider accepting a relatively short amortization period for private sector claims in exchange for a reduction in the face value of the flow of debt-service payments to these creditors (i.e., some combination of a reduction in the face value of the debts, and a below risk-free interest rate). This question needs to be answered with the interests of the debtor in mind—how far do the two contribute to resolving balance payments difficulties.

G. De Minimis

48. Paris Club agreements typically include a *de minimis* clause that specifies a threshold below which creditors are not required to participate in the restructuring. In the 1980s, bondholders as a class were on occasion treated as being *de minimis*. More recently, with the increasing importance of bonds as a vehicle for private sector financing, scheduled payments on bonds may be substantial. Nevertheless, there may be large number of creditors that may be involved in a private sector restructuring. This would be particularly the case in circumstances in which the bonds in question are held largely by individuals in the retail sector (e.g., Pakistan and Ukraine), and the likelihood that there may be a large number of individually small, but collectively significant, holdings. In such circumstances, the application of a *de minimis* provision could substantially reduce the base to which rescheduling would be applied. This suggests that it would not be appropriate to apply a *de minimis* provision to private creditors unless it is clear that only a small proportion of bonds are held by retail investors.

H. Comparability with a Range of Private Sector Instruments

49. The discussion above has assumed that the debtor had only one class of instrument held by private investors that needed to be restructured (international sovereign bonds). In practice, cases may arise in which there is a range of sovereign obligations to private creditors instead of, or in addition to, international bonds. (These could include short-term and medium-term claims of banks, as well as supplier credits.) Once the coverage of a Paris Club restructuring has been decided, there would be a question of the basis on which

³² If an exchange does not lead to a sufficient decline in secondary market yields, investors participating in an exchange would sustain mark-to-market losses.

comparability should be assessed. Should the assessment be made on a broad basis—taking an average of all relevant private sector claims—or on a creditor-class-by-creditor-class basis?

50. From the perspective of ensuring that programs are fully financed, as well as ensuring that the costs (and risks) are shared reasonably equitably between private and official creditor groups, a case could be made for assessing comparability on a broad basis. The responsibility for deciding how individual classes of private creditors are to be treated would rest with the debtor and its creditors. This approach has the attractiveness of conceptual simplicity. In practice, however, it is likely to raise a number of practical difficulties, which may point to making comparability assessments on a creditor-class-by-creditor-class basis, even though this latter approach inevitably may itself be quite complicated.

51. If some private credits are difficult to restructure (e.g., credits supported by security packages in the form of liens on receivables (Pakistan telecom bond)) achieving broad comparability would require other private creditors to provide more extensive relief than Paris Club creditors. This would, in effect, subordinate the unsecured claims of private creditors to the claims of Paris Club creditors, while subordinating both to secured private creditors. This would both complicate the task of pricing unsecured credits (to the extent that the prevalence of secured financing may not be known to markets prior to a restructuring) and strengthen incentives for private creditors to extend only secured credits.³³

52. Even in cases in which there are no secured creditors, the potential diversity of the claims of individual creditors (regarding, for example, type of instrument, overall exposure, arrears, maturing obligations during the program period) may force debtors to reach a number of separate restructuring agreements with private creditors. The process of reaching such agreements would be simplified if each could be assessed for comparability of treatment on its own merits, rather than attempt to negotiate comparability of treatment for all private sector creditors within a single agreement.

³³ While in principle, the Paris Club's comparability of treatment provision applies to secured credits, in practice there may be no feasible mechanism for the debtor to reach a restructuring. If the debtor cannot interrupt creditors' access to security, there would be no mechanism for engineering a credible threat of a default. In the absence of such a threat, it is likely that creditors would prefer continued payment to the option of restructuring.

COMPARABILITY OF TREATMENT

Presentation Displayed on the Paris Club Website³⁴

The Paris Club Agreed Minutes include a clause of “comparability of treatment,” which aims to ensure a balanced treatment among all external creditors of the debtor country. According to this clause, the debtor country commits itself to seek from non-multilateral creditors, notably other official bilateral creditor countries that are not members of the Paris Club and private creditors (mainly banks, bondholders and suppliers), a rescheduling on comparable terms to those negotiated within the Agreed Minute.

Paris Club creditors agree that no creditor should be regarded as inherently privileged. Paris Club creditors reschedule a country's debt to respond to a situation of imminent default, and in the context of the debtor's taking adequate measures to correct the situation through an IMF program. The Paris Club creditors seek to maximize recoveries. They typically require immediate repayment of as much of the original claim as possible. Amounts that cannot be repaid are rescheduled on terms that balance future payments with the objective of minimizing the chance that the debtor will return to the Paris Club with additional requests for forbearance.

The Paris Club creditors make an exception for multilateral creditors, such as the International Monetary Fund and the World Bank. Paris Club creditors agree that the debtor should meet its obligations to multilateral creditors before servicing other creditors' claims (multilateral debt treatment only occurs under the HIPC Initiative).

The Paris Club creditors do not expect that the debtor's agreements with its other creditors will exactly match the terms of the Paris Club's own agreement. Instead, considering the diversity of other possible creditors (non-Paris Club official bilateral creditors, banks, suppliers, bondholders, etc.), the Paris Club creditors require that the debtor seek terms that are “comparable” to the Paris Club's own agreement. The Paris Club creditors require the debtor to share with them the results of its negotiations with other creditors.

Paris Club creditors traditionally have taken a broad approach to assessing whether the debtor has provided comparable treatment. Factors for assessing comparability include, for each type of creditor, the changes in nominal debt service, net present value and duration of the restructured debt. No form of debt instrument is inherently protected from rescheduling. However, Paris Club creditors do consider on a case-by-case basis whether particular factors mitigate against demanding comparable treatment of a particular creditor or debt instrument(s). Creditors can make exceptions, for example, when the debt represents only a small portion of the debtor's burden, or if restructuring would unduly interfere with the

³⁴ See <http://www.clubdeparis.org/en/presentation/presentation.php?BATCH=B01WP06>.

smooth operation of trade. Short-term trade finance is generally excluded from a Paris Club rescheduling.

Non-Paris Club official bilateral creditors generally make the same type of medium-long term loans that the Paris Club creditors provide. Experience is that non-Paris Club official bilateral creditors often restructure on terms very similar to those agreed in the Paris Club. These creditors may also participate in Paris Club treatments as other official creditors, and under these circumstances apply exactly the same treatment as the one applied by Paris Club creditors.

By contrast, debtors' experience with external private creditors is more complex. There is an extensive track record of international banks rescheduling their exposures to sovereign borrowers, often through the so-called "London Club." Paris Club experience is that it may be more difficult to make a direct comparison between the efforts of creditors that choose to reschedule flows and those creditors that restructure stock of debt. For example, in recent cases where debtors have sought financial relief from bondholders, the debtors have offered a new bond(s) in exchange for the existing instrument. As a general rule, comparability of treatment is assessed with the effect of private treatments compared to the effect of Paris Club treatments (in terms of duration, net present value and flow relief). Since new money being provided can also be taken into account, the cutoff date that is being used for the internal purposes of Paris Club treatments does not apply to private creditors.

**Executive Board Seminar on the Treatment of the Claims of Private Sector and
Paris Club Creditors—Broad Areas of Agreement
August 23, 2001**

The following note provides a summary of broad areas of agreement among Executive Directors.

- Directors felt that many of the questions raised by the paper were beyond the Board’s technical expertise and mandate, but that the staff paper nevertheless provided a useful background to help advance the discussions between the staff and the Paris Club and between the Paris Club and the private sector on ways to address comparability of treatment and PSI.
- Directors saw merit in providing greater clarity with regard to the application of the principle of comparable treatment within the Paris Club so as to improve market confidence by reducing uncertainty, while at the same time retaining a flexible case-by-case approach.
- Directors urged continued cooperation and information sharing between the Fund and the Paris Club to ensure that questions of PSI, comparability, and medium-term sustainability are addressed effectively in the design of programs and in Paris Club rescheduling agreements.
- Although Directors generally did not consider the use of the catalytic approach for Paris Club reschedulings as appropriate, they confirmed the need for flexibility in requiring comparable treatment of private sector debt, including in cases private debt restructuring could affect future market access
- Directors supported the recent efforts of the Paris Club to improve transparency on its policies and practices, and, in this regard, welcomed the creation of the Paris Club website and the intensification of contacts with the private sector.
- Directors broadly agreed that the “as if” approach to debt rescheduling by the Paris Club was not feasible, as it would imply either the private sector providing relief without the assurance that the Paris Club would follow, or the Paris Club prematurely committing itself to future reschedulings.
- Directors did not support the use of reverse comparability, because Paris Club policies generally limit debt reduction to low-income countries, and relief provided through the Paris Club is just one of a number of channels through which support is provided to countries.



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International Monetary Fund
700 19th Street, NW
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**Involving the Private Sector in the Resolution of Financial Crises—
The Treatment of the Claims of Private Sector and Paris Club Creditors—
Preliminary Considerations**

On August 23, 2001, The Executive Board discussed the broad areas of agreement on the treatment of the claims of private sector and Paris Club creditors in an informal seminar.

- Directors felt that many of the questions raised by the paper were beyond the Board's technical expertise and mandate, but that the staff paper nevertheless provided a useful background to help advance the discussions between the staff and the Paris Club and between the Paris Club and the private sector on ways to address comparability of treatment and private sector involvement.
- Directors saw merit in providing greater clarity with regard to the application of the principle of comparable treatment within the Paris Club so as to improve market confidence by reducing uncertainty, while at the same time retaining a flexible case -by-case approach.
- Directors urged continued cooperation and information sharing between the Fund and the Paris Club to ensure that questions of private sector involvement, comparability, and medium -term sustainability are addressed effectively in the design of programs and in Paris Club rescheduling agreements.
- Although Directors generally did not consider the use of the catalytic approach for Paris Club reschedulings as appropriate, they confirmed the need for flexibility in requiring comparable treatment of private sector debt, including in cases where private debt restructuring could affect future market access
- Directors supported the recent efforts of the Paris Club to improve the transparency of its policies and practices, and, in this regard, welcomed the creation of the Paris Club website and the intensification of contacts with the private sector.
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- Directors did not support the use of reverse comparability, because Paris Club policies generally limit debt reduction to low -income countries, and relief provided through the Paris Club is just one of a number of channels through which support is provided to countries.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

The paper, *Involving the Private Sector in the Resolution of Financial Crises—The Treatment of the Claims of Private Sector and Paris Club Creditors—Preliminary Considerations*,” will be posted on the IMF’s external website.