IMF Publication

Reviews of the Fund's Sovereign Arrears Policies and Perimeter

INTERNATIONAL MONETARY FUND

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IMF POLICY PAPER

REVIEWS OF THE FUND'S SOVEREIGN ARREARS POLICIES AND PERIMETER

May 18, 2022

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

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 4, 2022 consideration of the staff report.
- The **Staff Report**, prepared by IMF staff and completed on February 24, 2022 for the Executive Board's consideration on May 4, 2022.
- Two **Staff Supplements** titled *Reviews of the Fund's Sovereign Arrears Policies and Perimeter—Supplementary Information*.

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

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IMF Executive Board Completes Review of the Fund's Policies on Sovereign Arrears and Related Perimeter Issues

FOR IMMEDIATE RELEASE

Washington, DC – May 18, 2022: On May 4, 2022, the Executive Board of the International Monetary Fund (IMF) completed a comprehensive review of the Fund's sovereign arrears policies, endorsing the main recommendations of the staff paper "Reviews of The Fund's Sovereign Arrears Policies and Perimeter." This is the last step in a multi-year modernization of the Fund's legal and policy framework for treatments of sovereign debt in IMF arrangements[1]). It adopts incremental but important amendments that aim to support more effective, orderly, and transparent resolution of sovereign debt difficulties in member countries.

Recognizing the disruptive nature of sovereign arrears for Fund members and the international community at large, the Fund's legal and policy framework for sovereign debt includes a policy of non-toleration of arrears (NTP) to international financial institutions and official bilateral creditors in specific circumstances, complemented by the policy on Lending Into Arrears (LIA) to private creditors, which was adopted in 1989 and last reviewed in 2002[2], and the Lending Into Arrears to Official Bilateral Creditors (LIOA) policy, adopted in 2015[3].

In light of the evolution in the creditor landscape—including the emergence of new official bilateral and International Financial Institution creditors and instruments—the Executive Board also endorsed staff's recommendations on the Fund's definitions and practices used to categorize claims when applying these arrears policies.

The main changes are in four areas:

1. The LIA policy has been revised to place greater emphasis on debt transparency, and streamlined by eliminating the reference to a formal negotiating framework.

2. The Fund's existing practice governing lending to members who are not in arrears but seeking a debt restructuring ("preemptive debt restructurings") is codified into a formal policy, with an emphasis on debt transparency along the lines of the LIA policy.

3. While the LIOA policy remains unchanged (given limited experience with its application since its adoption in 2015), the Fund's definition of an official bilateral claim was updated in

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[1] See Public Information Notice: IMF Executive Board Discusses Sovereign Debt Restructuring, Recent Developments and Implications for the Fund's Legal and Policy Framework; Press Release: IMF Executive Board Discusses Strengthening the Contractual Framework in Sovereign Debt Restructuring; Press Release: IMF Executive Board Approves Exceptional Access Lending Framework Reforms; Press Release: IMF Executive Board Discusses Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors.

[2] See Fund Policy on Lending into Arrears to Private Creditors–Further Consideration of the Good Faith Criterion.

[3] See Press Release: IMF Executive Board Discusses Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors.

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light of the recent evolution of the creditor landscape (such as new creditors and new types of instruments).

4. The NTP with respect to IFIs has been updated to provide clarity on how new IFIs will be treated. As is currently the case, the question of whether an IFI should benefit from the NTP will remain a judgment call informed by several factors. In addition to the existing factors—global membership, treatment by the Paris Club, and participation in the HIPC initiative—the Board will also consider whether the institution is a Regional Financing Arrangement and whether the IFI is receiving preferred creditor treatment by the official bilateral creditor community. For all other IFIs, the NTP would apply in cases when a restructuring involving official creditors is not required, while the LIOA would apply in the remaining cases.

Executive Board Assessment[4]

Directors welcomed the comprehensive review of the Fund's policy on lending into arrears to private creditors (LIA policy), the Fund's policy on lending into sovereign arrears to official bilateral creditors (LIOA policy), and the Fund's non-toleration of sovereign arrears policy to official bilateral and multilateral creditors.

Directors agreed that, overall, the Fund's arrears policies have worked well in enabling the Fund to proceed with providing financing in cases of arrears. At the same time, they noted that practice in sovereign debt restructuring and the creditor landscape have evolved over the last 20 years and certain updates are in order. Directors agreed that the proposals endorsed today are accurately reflected in the Executive Board understandings in Supplement 2 of the main paper to be issued shortly.

Directors agreed that the LIA policy remains broadly appropriate and agreed with staff's proposed updates to the principles guiding the Fund's assessment of good faith.

i. First, Directors agreed that debtors would be expected to share "relevant" information, generally aligned with what the member would be required to share under the Debt Limits Policy. They noted that this expectation would replace the earlier two-track approach on confidential and non-confidential information. Directors emphasized, however, that decisions on an adequate macroeconomic framework and the design of the financing plan or the adjustment program that could form the basis for the Fund's lending into arrears will remain in the sole purview of the Fund.

ii. Second, Directors considered that any terms offered to the creditors by the member should be consistent with the parameters of the Fund-supported program.

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

iii. Third, Directors expected that the debtor should provide clarity on the perimeter of claims that would be subject to the private-sector debt restructuring at the outset of the debt restructuring process.

iv. Fourth, Directors decided to eliminate the expectation that debtors would engage with creditor committees under a "formal negotiating framework" and only "where warranted by the complexity of the case." That said, Directors continued to expect that the debtor would engage with a representative creditor committee or committees.

v. Fifth, Directors reiterated their support for the use of flexibility in applying the LIA policy in emergency financing cases, in line with the flexibility provided under the LIOA policy.

Directors agreed that the current practice in preemptive restructuring cases remains appropriate and should be codified such that in those cases, the Fund may provide financing only if it has adequate assurances that such a restructuring will be successful. Such assurances are obtained by a judgment that a credible process for restructuring is underway and will result in sufficient creditor participation to restore debt sustainability and close financing gaps within the macroeconomic parameters of the program, taking into account official sector commitments. Directors welcomed the recommendation to add an expectation of enhanced transparency and information sharing in preemptive debt restructurings. A number of Directors cautioned against an overly prescriptive codification of the current practice.

With respect to claims held by official bilateral creditors, Directors broadly agreed that the Fund's nontoleration of arrears policy in cases where no official sector involvement is required (non-OSI cases) and the LIOA policy in cases where official sector involvement is required (OSI cases) continues to be appropriate and no amendments are needed. A number of Directors recalled the recent, novel application of the LIOA policy as a source of financing in the context of special circumstances, and emphasized that this approach could not be presumed to ensure debt sustainability outside these circumstances. Regarding the Fund's financing assurances policy, a number of Directors saw merit in conducting a review of the policy noting that it provides a critical safeguard for Fund lending. On the role of the Common Framework (CF), while a few Directors expressed a desire to recognize the CF as a representative standing forum now, most Directors agreed that more experience is needed and welcomed staff's plan to closely monitor the CF's evolution and revert to the Board on whether it emerges as a new representative standing forum.

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

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

implementation of the approach described in the Supplement would not fundamentally differ from that in the original proposal. Therefore, Directors endorsed the following:

- First, Fund financing in the face of arrears to the World Bank Group should continue to require an Agreed Plan between the debtor and the World Bank to clear the arrears over a defined period. Fund financing in the face of arrears to any other IFI should continue to require that a Credible Plan be in place in non-OSI cases.

- Second, in OSI cases:

    - Where the member is in arrears to an IFI, the Fund should judge whether a Credible Plan to resolve such arrears is required as a condition for lending. Factors informing the Fund's judgment in this regard will include: (i) global, rather than regional, membership of the institution; (ii) whether the institution is a regional financing arrangement or a reserve currency union central bank that forms part of the global financial safety net; (iii) the Paris Club's treatment of the institution, (iv) participation of the institution in the Heavily Indebted Poor Countries (HIPC) Initiative, and (v) whether the institution is being excluded from the scope of debt restructuring by official bilateral creditors through a creditor committee based on a representative standing forum recognized under the LIOA policy in the case at hand.

    - When arrears are owed to an IFI that is not captured under the above bullet, Directors agreed that the LIOA policy should be expanded to apply to these cases mutatis mutandis. In these cases, the Fund policy will also provide for the flexibility in extraordinary circumstances for emergency financing cases consistent with the LIOA policy.

Directors broadly agreed with staff's restatements of how a Direct Bilateral Claim is defined for purposes of the application of the Fund's arrears, financing assurances, and debt sustainability policies, with some Directors emphasizing that the Fund's definition should aim to align with the classifications of the World Bank and Paris Club. They also endorsed two amendments with respect to identifying official claims. First, to the extent that the IFI purchases securities in the secondary market as part of the global financial safety net, such claims can be treated as claims subject to the Fund's arrears policies as applicable to IFIs. However, the Fund would rely on the IFI's own representation in this regard. Second, any Direct Bilateral Claims or claims held by IFIs that are contractually part of a pooled voting mechanism with private creditors shall be subject to the LIA policy. Directors asked that staff reports include greater transparency on how staff assessed the perimeter of claims, including when the Fund's classifications differ from that of the Paris Club's. A few Directors called on the Fund to treat central bank swaps with utmost caution, considering its unique characteristics.

The above amendments and restatements will enter into effect immediately and will apply to all future purchases and disbursements (including under existing arrangements), with respect to existing and future arrears.

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

INTERNATIONAL MONETARY FUND

February 24, 2022

REVIEWS OF THE FUND'S SOVEREIGN ARREARS POLICIES AND PERIMETER

EXECUTIVE SUMMARY

This paper undertakes a comprehensive review of the Fund's sovereign arrears policies. The arrears policies determine the conditions under which the Fund can lend to a member in the presence of sovereign arrears (after it has defaulted on a financial obligation). The paper also reviews the conditions for Fund lending to member countries seeking to restructure privately held claims preemptively (i.e., before a default occurs and arrears arise). Finally, as the creditor landscape has evolved, the Fund's definitions and practices used to categorize claims for purposes of applying these policies are in need of a review and should be updated.

Staff assesses that the Fund's Lending into Arrears to Private Creditors (LIA) policy (established in 1989 and last reviewed in 2002) remains broadly appropriate, while recommending some improvements given the experience gained over the last 20 years. These include amendments to the guiding principles on "good faith" efforts by the debtor under the LIA policy, including to simplify requirements for engagement with creditor committees (by eliminating the references to a formal negotiating framework) and to add that any debt restructuring offer by the debtor should restore debt sustainability consistent with the program parameters (in line with the Fund's Lending into Arrears to Official Bilateral Creditors (LIOA) policy). Staff also recommends providing additional guidance on the sharing of relevant information with creditors, with a particular focus on debt transparency.

Staff also sees merit in codifying the existing practice guiding the Fund in *preemptive* debt restructurings into a Fund policy, together with an amendment focusing on debt transparency. This recommendation reflects the increased use of preemptive debt restructurings over the last 20 years and input received in outreach to the private sector and other stakeholders. In line with the existing practice, the new policy would state that in such settings, the Fund can lend if a credible process for debt restructuring is underway and such debt restructuring will likely deliver debt sustainability in line with program parameters. Furthermore, it would provide that in assessing whether a credible process for debt restructuring is underway, staff would usually expect the member to share relevant information with its creditors along the lines of the guiding principles under the LIA policy.

Given limited experience with the application of the LIOA policy (established in 2015), staff does not propose any amendments but only one restatement confirming current practice. This refers to the fact that once a claim is determined to be Official Sector Involvement (OSI)-related (where restoration of debt sustainability requires restructuring official bilateral claims), that determination will carry forward to future Fund arrangements. In light of the recent practice with the G20 Common Framework for debt treatments beyond the DSSI, staff will monitor whether a new representative standing creditor forum may emerge with which the Fund may decide to engage in the future under the LIOA policy.

Given recent developments in the international creditor community, staff proposes refining the Fund's arrears policies with respect to multilateral creditors. Arrears to multilaterals are currently subject to the non-toleration policy (NTP), where (with the exception of the World Bank Group) the designation of "multilateral" is based on a judgment informed by factors including global membership, and treatment by the Paris Club and under the Heavily Indebted Poor Countries (HIPC) Initiative. This approach offers little guidance on how to treat *new* International Financial Institutions (IFIs) with regional membership, which have been proliferating in recent years. Treating them all as multilaterals would dilute the value of the NTP and complicate crisis resolution when OSI is required. To address this, staff proposes two main reforms for OSI cases, while retaining the current approach for the World Bank Group (where an Agreed Plan to clear arrears will continue to be required) and in non-OSI cases (where all IFIs with two or more sovereign members would continue to be subject to the NTP):

i. In OSI cases, the NTP will cover only IFIs whose (i) mandate/financing is closely aligned with the Fund's mandate to provide financing to help members resolve their Balance of Payments (BOP) problems, such as Regional Financing Arrangements (RFAs) and global Multilateral Development Banks (MDBs), or (ii) where the treatment by official bilateral creditors belonging to a representative standing forum—as recognized under the LIOA policy—in the restructuring at hand (or the anticipated treatment informed by past practice) excludes that IFI from the scope of the debt restructuring.

ii. Claims of those IFIs not covered by the NTP above would be subject to the (expanded) LIOA policy—paralleling the treatment received by official bilateral claims.

Finally, recent developments raise questions about the perimeter between official bilateral and private claims, with significant implications for the Fund's arrears policies. In updating the Fund's definition of an official claim for purposes of the arrears policies, staff proposes several restatements, as well as two amendments, in particular: (1) to exclude claims of official bilateral creditors and IFIs subject to vote pooling with the private sector from LIOA and NTP treatment, respectively, to avoid a situation where holdings of the same instrument could receive different treatment depending on the holder; and (2) to clarify the treatment under the Fund's arrears policies of claims purchased in the secondary market by official bilateral creditors and IFIs.

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[1] The team would like to acknowledge contributions from Ali Abbas, Charlotte Lundgren, Sanaa Nadeem, Alex Pienkowski, Bahrom Shukurov and Hajime Takizawa (all formerly SPR) to previous work on the LIA review.

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FIGURES

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ANNEXES

Abbreviations and Acronyms

BIS	Bank for International Settlements
BOP	Balance of Payments
CAC	Collective Action Clause
CF	G20 Common Framework for debt treatments beyond DSSI
CUCB	Currency Union Central Bank
DLP	Debt Limits Policy
DSA	Debt Sustainability Analysis
DSSI	Debt Service Suspension Initiative
ECA	Export Credit Agency
ECB	European Central Bank
ECF	Extended Credit Facility
EFF	Extended Fund Facility
ESM	European Stability Mechanism
GCAB	Global Committee of Argentina Bondholders
GFSN	Global Financial Safety Net
FN	Footnote
HIPC	Heavily Indebted Poor Countries
ICMA	International Capital Market Association
IFI	International Financial Institution
IIF	Institute of International Finance
IMF	International Monetary Fund
LIA	Lending into Arrears
LIC	Low Income Country
LIOA	Lending into Official Arrears
MDB	Multilateral Development Bank
MDRI	Multilateral Debt Relief Initiative
MPA	Multi-Pronged Approach
NPV	Net Present Value
NTP	Non-Toleration of Arrears Policy
OECD	Organization for Economic Co-operation and Development
OMT	Outright Monetary Transactions
OSI	Official Sector Involvement
PC	Paris Club
PCS	Preferred Creditor Status
PRGT	Poverty Reduction and Growth Trust
PSI	Private Sector Involvement
RCF	Rapid Credit Facility
RCUCB	Reserve Currency Union Central Banks
Rep. PC	Representative Paris Club Agreed Minute
RFA	Regional Financing Arrangements
RFI	Rapid Financing Instrument

SBA	Stand-By Arrangement
SMSF	Secondary Market Support Facility
SWF	Sovereign Wealth Fund