INTRODUCTION

1. **This paper undertakes a comprehensive review of the Fund's sovereign arrears policies.** Recognizing the destructive nature of arrears, since 1970, the Fund has had a policy of non-toleration of arrears (NTP), unless a specific policy applies that enables the Fund to lend into sovereign arrears.[2] These specific policies are those on Lending into Arrears (LIA) to private creditors—which was adopted in 1989 and last reviewed in 2002—and on Lending into Arrears to Official Bilateral Creditors (LIOA), which was adopted in 2015.[3] As described in more detail below and in Annex III, the application of the specific arrears policies depends on (i) whether a sovereign ("member" or "debtor") is in arrears to private sector, official bilateral, or multilateral creditors, and (ii) whether Private Sector Involvement (PSI) and/or Official Sector Involvement (OSI) is needed.[4, 5]

2. **This paper reviews the application of the sovereign arrears policies and proposes updates to these policies to make them more effective in the current sovereign debt landscape**. Despite several attempts—most recently in line with the sovereign debt work program endorsed by the Executive Board in May 2013—the LIA policy has not been reviewed since 2002.[6, 7] The Executive Board established the Fund's LIOA policy in 2015, with an expectation that it would be reviewed in two to three years.[8] The Fund's NTP has not been comprehensively reviewed since its establishment in 1970.[9] In addition, as the creditor landscape has evolved, it has become increasingly clear that the Fund's definitions and practices used to categorize claims for purposes of applying these different arrears policies should be reviewed as well and updated as needed.

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[2] See: IMF, 2018, Prevention and Resolution of Sovereign Debt Crises (Washington) at Prevention and Resolution of Sovereign Debt Crises | imfsg.

[3] Summing Up by the Chairman—Fund Involvement in the Debt Strategy, May 1989; The Acting Chair's Summing Up—Fund Policy on Lending into Arrears to Private Creditors— Further Consideration of the Good Faith Criterion , September 2002; The Chairman's Summing Up— Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors, December 2015.

[4] Arrears arise when a debtor does not pay its contractual financial obligation under a debt instrument to a creditor or creditors in full and by the contractual due date, including any grace periods.

[5] "OSI" and "PSI" mean that the Fund-supported program does not provide for full repayment of the claim and needs a contribution from the official sector or private sector, respectively, which can consist of debt relief and new financing (e.g., loans, bond financing, guarantees, and grants). The framework for involving the private sector in crisis resolution, relying as much as possible on market-oriented solutions and voluntary approaches, was endorsed by the IMFC at its meeting in Prague in September 2000 (see IMFC, Communique, 2000 and IMF 2001, Report of the Managing Director to the International Monetary and Financial Committee on Private Sector Involvement in the Prevention and Resolution of Financial Crises, IMFC/Doc/4/01/5).

[6] The Acting Chair's Summing Up—Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion, September 2002.

[7] Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework, April 2013. The review of the LIA is the fourth and last leg of the Fund's work program on sovereign debt launched in 2013.

[8] Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors, December 2015; The Chairman's Summing Up—Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors, December 2015.

[9] Payments Arrears in Current International Transactions, October 1970.

3. The paper is organized as follows. The next section reviews the existing legal and policy framework. The following sections review, in turn, the LIA policy, the preemptive debt restructurings practice, the LIOA policy, and the NTP for multilaterals and recommend proposed targeted amendments. The paper then tackles the contours of the definitions of direct bilateral claims and multilateral claims. Last, the paper raises issues for discussion.

EXISTING LEGAL AND POLICY FRAMEWORK

4. Under its Articles of Agreement (the "Articles"), the Fund may only provide financing to assist members to resolve their balance of payments (BOP) problems under adequate safeguards. Article I(v) and Article V, Section 3(a) of the Articles require the Fund to adopt policies that will assist members in resolving their BOP problems and that will establish adequate safeguards for the temporary use of the general resources of the Fund. In other words, Fund financing can only be provided in support of a member's economic policies that are capable of resolving the member's BOP problems over a timeframe consistent with the revolving nature of Fund financing aimed at restoring the member to medium external viability.[10] The inter-related policies on financing assurances, debt sustainability, market access, and arrears, which are germane to restoring medium term external viability, help the Fund achieve these objectives.[11] For the Fund to provide financing, it must determine that the requirements under each of these policies have been met.

A. Financing Assurances, Debt Sustainability, and Market Access

5. The financing assurances policy requires Fund-supported programs to be fully financed.[12] Program financing includes assumptions regarding a member's expected financing from private sector creditors (including (re)gaining market access, if relevant), the clearance of arrears, as well as the envisaged debt restructuring operation. Under the Fund's financing assurances policy, the Fund must be satisfied that program financing is adequate to fill financing gaps during the program period to ensure external viability, as well as to ensure that the member is in a position to repay the Fund during the post-program period. Specifically, this requires that in the event that there are gaps with respect to new external financing to be provided by the official sector: (i) "firm commitments" of financing must be in place for the upcoming 12 months of the arrangement, and (ii) "good prospects" that there will be adequate financing for the remaining

[10] Guidelines on Conditionality, Decision No. 12864-(02/102), September 2002, as amended.

[11] Policies referring to restoring market access are not directly relevant for Fund members that have not historically had market access.

[12] Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework, April 2013. Because there is no economic program underlying emergency financing, the financing assurances policy is limited in such cases to a judgment that the member will be in a position to repay the Fund.

program period beyond the upcoming 12 months.[13] With respect to the post-program period, staff needs to assess whether the member's prospective policies deliver a projected post-program macroeconomic performance that adequately safeguards repayments to the Fund consistent with a sustainable debt path. A Fund-supported program in the Fund's General Resources Account (GRA) is designed to restore the member to medium term external viability and resolve the BOP problem within the program period.[14, 15, 16]

6. **Where a member's debt is assessed as unsustainable, the Fund is precluded from providing financing unless the member takes steps to restore debt sustainability.**[17] A combination of policy adjustment and financing from public and private sources has been sufficient to preserve debt sustainability in the vast majority of Fund-supported programs. The catalytic role of Fund financing is however put to the test in cases where members with significant external indebtedness have lost—or are losing—market access.[18]

7. **Closely related to—but distinct from—the concept of debt sustainability is that of market access.**[19] While lack of debt sustainability normally triggers loss of market access, temporary loss of market access does not necessarily imply that debt is unsustainable. Whether a member is assessed to have market access will depend on its ability to tap international capital markets on a sustained basis through the contracting of loans and/or issuance of securities across a range of maturities, regardless of the currency denomination of the instruments, and at reasonable interest rates.[20] The Fund's exceptional access policy, *inter alia*, requires that the member has

[13] During program reviews, assurances on full financing of successive 12-month periods beyond the initial 12 months (or whatever period is left under the arrangement) must be ascertained. Specifically, the "good prospects" must become "firm commitments" or actual financing.

[14] 2018 Review of Program Design and Conditionality, May 2019.

[15] For ECF arrangements under the PRGT, it may not be feasible to fully resolve the protracted BOP problems within the program period. In this context, the existence of post-program financing gaps could be more explicitly recognized with appropriate safeguards. Post-program financing gaps can be justified when the sensitivity analysis confirms that capacity to repay remains adequate and debt remains sustainable under realistic financing assumptions, including level of funding on non-concessional terms to close the post-program financing gaps.

[16] Staff needs to assess that the member has good prospects for (re)gaining access to capital markets at sufficient depth, maturity, and price to ensure capacity to repay the Fund and consistent with a sustainable debt path, taking into account all sovereign maturities falling due in the post-program period during the time repayments to the Fund are outstanding. As long as obligations to the Fund are outstanding, staff needs to judge that there no financing gaps in the post-program period at arrangement approval and each respective program review.

[17] See the definition of public debt sustainability: "In general terms, public debt can be regarded as sustainable when the primary balance needed to at least stabilize debt under both the baseline and realistic shock scenarios is economically and politically feasible, such that the level of debt is consistent with an acceptably low rollover risk and with preserving potential growth at a satisfactory level." See, Review of the Debt Sustainability Framework for Market Access Countries, January 2021.

[18] Market access is lost when sovereigns default or stop issuing bonds controlling for financing needs and previous pattern of issuance. See, The Fund's Lending Framework and Sovereign Debt—Further Considerations, April 2015.

[19] *Id*.

[20] *Id*.

prospects of (re)gaining access to private capital markets within the timeframe Fund resources are outstanding.

8. When debt is unsustainable, but a member is not yet in arrears, the Fund requires assurances that debt sustainability will be restored and the program will be fully financed.[21] While the arrears policies described in the following section may fill this role in cases where the debtor has defaulted on external creditors (see Annex I for further details), the standards for these assurances in *preemptive* debt restructurings derive from the debt sustainability and financing assurances policies. The financing assurances policy does not prescribe the burden sharing between creditors, including official and private creditors, provided the member achieves high private sector creditor participation. The form of such assurances depends on the nature of the creditors:

- The Fund requires "specific and credible" assurances on debt relief and/or financing from official bilateral creditors, which should preferably take the form of a written communication from the creditor showing an understanding of the debtor member's situation and a commitment to the needed actions to restore debt sustainability and financing in line with program parameters.[22] In practice, a similar standard of "specific and credible" assurances on financing applies to new financing being provided by International Financial Institutions (IFIs) to help restore debt sustainability and close program financing gaps.

- When a contribution from private creditors is required to restore debt sustainability and to close financing gaps, assurances are derived from the Fund's judgment that a credible process for debt restructuring is underway and such debt restructuring will likely deliver an outcome in line with program parameters. Relevant considerations to form such judgment include the engagement of legal and financial advisors by the member, the launching of consultations with creditors, and the design of the debt restructuring strategy, including the terms of the new instruments and use of inducements for creditor participation.[23]

9. When debt is unsustainable and the member is in arrears to its private creditors, the Fund may consider that debt sustainability will be restored if (i) the member's debt restructuring offer (if any) is sufficient to restore debt sustainability consistent with the program parameters and (ii) the criteria under the LIA policy are satisfied (as described in

[21] See Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework, April 2013, Annex I at para. 4.

[22] For Paris Club creditors, these credible and specific assurances on debt relief and/or financing generally take the form of a preliminary indication that the Paris Club is willing to provide debt relief in anticipation of an Agreed Minute.

[23] The debt restructuring should normally be undertaken before the approval of the Fund arrangement. However, there may be circumstances under which more flexibility is warranted, such that the conclusion of the debt operation is contemplated at a later date—normally, by the first review under the Fund arrangement. Against this background, it would not be necessary to hold up Fund support until there is complete clarity regarding the terms of this financing. See, The Acting Chair's Summing up—The Fund's Lending Framework and Sovereign Debt—Further Considerations, January 2016.

detail below).[24, 25] The criteria under the LIA policy act as a safeguard to give the Fund assurance that if the member is meeting those requirements, a debt restructuring deal will be forthcoming and arrears will be resolved. The Fund may decide that no further "assurances" regarding the restoration of debt sustainability are required. As an additional safeguard, the financing assurances reviews required under the LIA policy allow the Fund to assess the status of debtor-creditor negotiations, and whether further progress is being made to reach agreement on a debt restructuring. If, in the context of such reviews, the Fund determines that the member is no longer in compliance with the LIA policy and a debt restructuring deal is unlikely to be forthcoming, the Fund can decide not to approve Fund financing.

10. When debt is unsustainable and the member is in arrears to its official bilateral creditors, the Fund may consider that debt sustainability will be restored, provided the requirements under the Fund's LIOA policy are satisfied (as described in detail below).[26] However, the requirements under the LIOA policy are more stringent in certain respects: In particular, the application of the LIOA policy is normally dependent on an agreement being reached between the debtor and a (representative) majority of its official bilateral creditors. Therefore, in practice, the LIOA is normally applied to minority hold-out creditors. In certain cases, including where the creditor provides consent, the Fund may proceed to lend under the LIOA policy even in the presence of arrears to a majority creditor or creditors (see discussion in paragraph 49 below). However, given that, in general, a durable solution to a BOP problem requires a debt restructuring which is unlikely to be achieved without the participation of large creditors, the Fund may ultimately judge that, despite compliance with the requirements under the LIOA policy, the overall risks to the Fund-supported program may be too high to proceed.

B. Arrears Policies

11. When a member is in arrears to external creditors at the time Fund financing is requested (for instance, at either approval of or a review under an arrangement), the arrears

[24] This includes cases where, under the exceptional access policy (see, Access Policy and Limits in the Credit Tranches and Under the Extended Fund Facility and on Overall Access to the Fund's General Resources, and Exceptional Access Policy—Review and Modification, Decision No. 14064-(08/18), as amended), debt sustainability must be restored with a high probability. If the member's offer has not yet been made, the Fund could proceed if an offer consistent with debt sustainability is expected to be forthcoming.

[25] In this regard, the safeguards under the LIA policy also give the Fund assurances that market access will be restored. The LIA policy is predicated on the basis that if the criteria are met, orderly relations between the debtor and its creditor(s) are being restored. As such, this would also mean that in due course, market access will be restored.

[26] As further described in Annex I, the Fund may consider that debt sustainability will be restored if either the criteria under the LIOA are satisfied or the Executive Director for the creditor member provides consent to Fund financing notwithstanding arrears owed to it.

policies (LIA or LIOA) must be satisfied for the Fund to lend.[27, 28] Recognizing the destructive nature of external payments arrears to both national and international prosperity (see Article I(v)), the Fund encourages members to stay current on their obligations to the extent possible. However, where that is not possible, the arrears policies give the Fund the possibility to continue providing financing in the face of difficulties that may emerge for the member in securing an agreement with its creditors on terms consistent with the parameters of the Fund-supported program, provided the Fund judges that the member meets the requirements under these policies. The arrears policies therefore enable the Fund to tackle the hold-out problem by removing the veto power from creditors. At the same time, the arrears policies provide creditors with comfort that the debt relief or financing sought by the member from its creditors is consistent with a balance between financing and adjustment that has been endorsed by the Fund.

Private

12. The LIA policy governs Fund lending in the face of arrears to external private creditors and on other types of external debt claims.[29] The LIA policy was initially established to apply to sovereign arrears to external creditors on bank loans and was extended to also address sovereign arrears to other private creditors, including bondholders, and non-sovereign arrears that arise from the imposition of exchange controls (see Box 1 and Annex III).

[27] The Fund takes a claim-by-claim determination whether the LIA or the preemptive restructuring practice applies; therefore, the LIA only applies to an external debt claim in arrears. "External" is defined in terms of residency of the creditor.

[28] The Fund's arrears policies do not apply to arrears in dispute. Under this practice, where the Fund accepts a member's representation that the validity or amount of a debt claim is in dispute, such disputed claim does not give rise to arrears for Fund purposes. However, such claims are taken into account (as a contingent claim) for purposes of determining whether adequate assurances exist for the financing of a Fund-supported program and the Fund DSA. See Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework, April 2013, Annex I, at FN. 11.

[29] The Fund's LIA policy has never formally defined the scope of "payments arrears." However, the evolution of the arrears policies and their coverage is informative. Accordingly, the Executive Board has applied the LIA policy to obligations arising from "commercial financial obligations of a contractual nature" that are not paid when due (taking into account any contractual grace periods). For example, arrears on bank loans, suppliers' credits (i.e., where the creditor contractually defers payment, or the good/service does not need to be paid on delivery), and since 1999 bonds have been included in the scope of the LIA policy. However, the LIA policy has not been applied more broadly to arrears on non-debt obligations (e.g., financial obligations originating from an arbitral award, unpaid dues, payment on delivery).

Box 1. Lending Into Arrears (LIA) Policy

Under the LIA policy, the Fund may provide financing despite sovereign arrears to private creditors on a case by case basis and only where (i) prompt Fund support is considered essential for the successful implementation of the member's adjustment program, and (ii) the member is pursuing appropriate policies and it is making a good faith effort to reach a collaborative agreement with its private creditors (or to facilitate a collaborative agreement between private debtors and creditors and a good prospect exists for the removal of exchange controls).[1]

The assessment of "good faith" is guided by the following principles:

- First, when a member has reached a judgment that a restructuring of its debt is necessary, it should engage in an early dialogue with its creditors, which should continue until the restructuring is complete.
- Second, the member should share relevant, non-confidential information with all creditors on a timely basis, which would normally include:
    i. an explanation of the economic problems and financial circumstances that justify a debt restructuring;
    ii. a briefing on the broad outlines of a viable economic program to address the underlying problems and its implications on the broad financial parameters shaping the envelope of resources available for restructured claims;
    iii. and the provision of a comprehensive picture of the proposed treatment of all claims on the sovereign, including those of official bilateral creditors, and the elaboration of the basis on which the debt restructuring would restore medium term sustainability, bearing in mind that not all categories of claims may need to be restructured.
- Third, the member should provide creditors with an early opportunity to give input on the design of restructuring strategies and the design of individual instruments.
- Finally, in cases in which an organized negotiating framework is warranted by the complexity of the case and by the fact that creditors have been able to form a representative committee on a timely basis, there would be an expectation that the member would enter into good faith negotiations with this committee, though the unique characteristics of each case would also be considered.[2] This formal negotiating framework would include, *inter alia*, the sharing of confidential information needed to enable creditors to make informed decisions on the terms of a restructuring, and the agreement to a standstill on litigation during the restructuring process by the creditors represented in the committee.

With respect to the imposition of exchange controls (jurisdictional arrears), the LIA provides the following guidance:[3] Fund lending into non-sovereign arrears stemming from the imposition of exchange controls should be on a case-by-case basis and only where:

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

Box 1. Lending Into Arrears (LIA) Policy (concluded)

In emergency situations, such as for requests of the Rapid Credit Facility (RCF) and the Rapid Financing Instrument (RFI), the LIA policy applies with flexibility in the wake of conflicts and natural disasters.[4]

So long as a member has outstanding arrears to private creditors, all purchases made by such member under a Fund arrangement are subject to financing assurances reviews, which will provide an opportunity for the Fund to monitor relations between a debtor and its creditors, and for the Executive Board to be kept informed about developments in this area at an early stage.

[1] The Acting Chair's Summing Up—Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion, September 2002.

[2] *Id.*

[3] The Acting Chair's Summing up—Fund Policy on Arrears to Private Creditors—Further Considerations, June 1999.

[4] The Acting Chair's Summing Up - The Fund's Engagement in Fragile States and Post-Conflict Countries-A Review of Experience-Issues and Options, March 2008.

Official Bilateral

13. Arrears on claims held by official bilateral creditors are subject to different policies depending on the nature of the claim. Official bilateral creditors hold a variety of claims on other sovereigns, reflecting the many functions such creditors play in the international financial architecture. These claims are held in different forms and are extended or purchased for different public-policy reasons. However, the Fund's arrears policies give preferential treatment to only the subset of these claims that are Direct Bilateral Claims, i.e., claims that are (a) held by a government, or an agency acting on behalf of a government; and (b) originate from an underlying transaction where the creditor government, or an agency acting on behalf of the government, provided or guaranteed financing to the borrowing member.[30, 31, 32] While other types of official financing are also critical to the operation of domestic and international financial systems, the Fund has recognized this specific type of financing as closely tied to the Fund's operations as it provides critical contributions to Fund-supported programs, constitutes BOP support, and often is extended during crises when the private sector becomes unwilling to provide support. Another type of important official financing is central bank swap lines which may be part of the Global Financial Safety Net (GFSN) or direct sovereign-to-sovereign BOP financing. Where such central bank swaps are extended on behalf of the government for BOP purposes, they are a Direct Bilateral Claim and subject to the Fund's arrears policies.

[30] Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors, December 2015.

[31] While the 2015 Paper establishing the LIOA policy referred to these types of claims as "official claims," that was a misnomer. The claims covered by the LIOA policy are only a subset of official claims, specifically the claims held by official bilateral creditors that fall under the definition in the preceding paragraph. *Id.*

[32] Claims guaranteed by governments or agencies acting on their behalf are provided this preferential treatment once the guarantee has been called. *Id.* Debt claims as well as other sovereign-to-sovereign financial claims such as a payment on delivery, and debt-related arbitral awards are covered.

14. As set forth in paragraph 1 above, the treatment afforded under the arrears policies to Direct Bilateral Claims depends on whether contributions from the official sector (Official Sector Involvement or OSI) are required under the Fund-supported program.[33] In non-OSI cases, the Fund's NTP applies to arrears on Direct Bilateral Claims—i.e., the Fund may only provide financing if the creditor's Executive Director acquiesces or does not object to the Fund approving financing despite the arrears. In OSI cases, the LIOA policy applies to these claims (Box 2). Claims held by official bilateral creditors on sovereigns that are not Direct Bilateral Claims are treated under the LIA policy in practice (Box 1).

Box 2. Lending Into Arrears to Official Bilateral Creditors (LIOA) Policy

The LIOA policy allows Fund financing despite sovereign arrears to official bilateral creditors on Direct Bilateral Claims in carefully circumscribed circumstances.[1] The LIOA policy was introduced in 2015 "to ensure that, where a restructuring is deemed necessary, collective action among official bilateral creditors is encouraged and the provision of Fund support is not held up by the unwillingness of hold-out creditors to join an effort that is supported by an adequately representative group of creditors."[2] Under the LIOA policy, where OSI is required, the Fund may provide financing despite arrears on Direct Bilateral Claims where:

- There is a representative Paris Club agreement (i.e., providing a majority of the total financing contributions—meaning new financing and/or debt relief—required from official bilateral creditors over the program period). In such cases, based on the Paris Club's comparability of treatment principle, arrears are considered eliminated ("deemed away") for purposes of the LIOA policy for both participating and non-participating creditors when financing assurances are received from the Paris Club in anticipation of an Agreed Minute. The Executive Board has indicated,[3, 4] however, that "should another representative standing forum emerge, the Fund would be open to engaging with such a forum." Affording another representative standing forum similar status to the Paris Club under the LIOA policy would require an Executive Board decision;
- Creditor consent has been provided, in the absence of a representative Paris Club Agreement; or
- In the absence of a representative Paris Club agreement or creditor consent[5], if the following three criteria hold: (i) prompt financial support from the Fund is considered essential, and the member is pursuing appropriate policies; (ii) the debtor is making good faith efforts to reach agreement with the creditor on a contribution consistent with the parameters of the Fund-supported program—i.e., that the absence of an agreement is due to the unwillingness of the creditor to provide such a contribution; and (iii) the decision to provide financing despite the arrears would not have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases. The Executive Board has provided guidance on how to apply the second and third criteria. The assessment of "good faith" will take into account, *inter alia*, whether the debtor:

[33] "Contribution" here comprises, and is limited to, debt relief and new financing (e.g., loans, bond financing, guarantees, and grants).

Box 2. Lending Into Arrears to Official Bilateral Creditors (LIOA) Policy (concluded)

i. has approached the creditor to which it owes arrears either bilaterally or through a relevant grouping of official bilateral creditors;

ii. has offered to engage in substantive dialogue with the creditor and has sought a collaborative process with the creditor to reach agreement;

iii. has provided the creditor relevant information on a timely basis consistent with the Fund's policy on confidentiality of information; and

iv. has offered the creditor terms that are consistent with the parameters of the Fund-supported program and consistent with the contributions from other official bilateral creditors.

- In assessing the third criterion, the Fund will consider the signal that such a decision would send to official bilateral creditors as a group, given the specific circumstances of the case. This criterion would normally not be satisfied where the creditor or group of creditors that has not reached agreement with the debtor accounts for an adequately representative share. Separately, an assessment of whether the third criterion is satisfied would take into consideration the creditor's track record of providing contributions in past debt restructurings under Fund-supported programs, even if the creditor does not account for an adequately representative share of total financing contributions.

In emergency situations, where the extraordinary demands on the affected government are such that there is insufficient time for the debtor to undertake good faith efforts to reach agreement with its creditors, the Fund may provide financing under the RCF or the RFI despite arrears owed to official bilateral creditors and without assessing whether the three criteria above have been satisfied or obtaining the creditor's consent.

Finally, so long as unresolved arrears owed to official bilateral creditors are outstanding, every purchase or disbursement made available after the approval of the arrangement is subject to a financing assurances review by the Executive Board.

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[1] Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors, December 2015.

[2] The Chairman's Summing Up—Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors, December 2015.

[3] To the extent that arrears are not rescheduled by the deadline set forth in the Agreed Minute, the arrears are considered to arise anew for program purposes, unless the Fund considers that the member is exercising its best efforts to conclude the bilateral agreement in line with the terms of the Agreed Minute.

[4] This special recognition of agreements reached in the Paris Club is based on long-standing Fund policy and close coordination with the Paris Club. The Acting Chairman's Summing Up—Settlement of Disputes Between Members Relating to External Financial Obligations—Role of the Fund, July 1984; IMF, Prevention and Resolution of Sovereign Debt Crises, Selected Legal and Institutional Papers Series, 2018.

[5] Creditors generally provide explicit consent prior to the circulation of the staff report for use of Fund resources to the Executive Board. However, where the relevant Executive Director has, despite repeated inquiries, not received a response from the creditor authorities, staff follows a less stringent "deemed consent" approach, under which consent is assumed absent the receipt of an objection. Application of the Fund's Policy on Arrears to Official Bilateral Creditors—Modalities of Creditor Consent, April 2017.

Multilateral

15. Multilateral creditors play an important role in the international financial architecture. They are better placed than official bilateral creditors to pool risk, internalize global externalities, and overcome collective action problems. Their role is widely recognized by the international creditor community which accords certain multilateral claims special treatment. The rationale for this treatment is based on the Articles, which require the Fund to assist its members in solving BOP problems without resorting to measures destructive of national or international prosperity (Article I(v)). The Fund's NTP provides special protection to claims of multilateral institutions arising from activities that help the Fund achieve this objective.

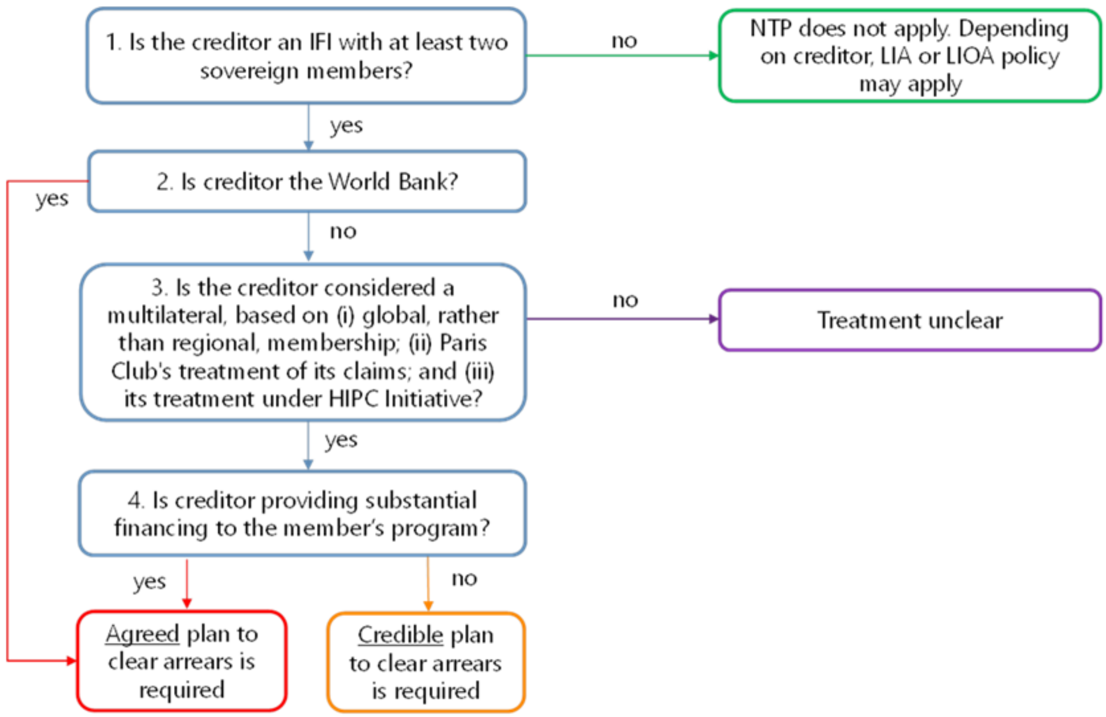
16. Arrears on claims held by multilateral creditors are subject to the NTP (Figure 1).[34] Fund-supported programs have long required the resolution of existing arrears and the non-accumulation of new arrears during the program period with respect to multilateral creditors.[35] While membership with at least two sovereign members is a necessary condition, the Fund does not have a clear definition of a multilateral creditor or an agreed list of such institutions. Instead, the Fund considers a number of factors in making such a judgment, including (i) global, rather than regional, membership of the institution, (ii) the Paris Club's treatment of the institution and the institution's participation in the Paris Club, and (iii) the treatment of the institution under the Heavily Indebted Poor Countries (HIPC) Initiative. Arrears to multilateral creditors are considered resolved if, in the Fund's judgment, the debtor has a credible plan and projected financing to eliminate arrears over a defined period (Credible Plan). Such a plan must be credible to Fund staff—and ultimately the Executive Board—but the creditor's concurrence is not required. However, for the World Bank Group or multilaterals providing substantial financing (i.e., net positive BOP financing) to the Fund-supported program, the creditor's agreement with the arrears clearance plan over a defined period has generally been required (Agreed Plan).[36] The current NTP is silent on the treatment of claims to IFIs that are not considered "multilateral creditors".

[34] While the current policy explicitly looks at the status of the institution, in practice, it also takes into account the type of claim held by the multilateral institution. Claims related to IFI financing of a global public good nature, even outside the context of resolving BOP problems, have been protected by the NTP while arrears on other types of claims—such as membership fees or treasury/investment operations—have been considered to fall outside the NTP. Most overdue membership fees are owed to multilateral non-financing institutions—and key IFIs do not impose membership fees—so non-payment does not affect a country's ability to access external financing. Further, in most cases, amounts of overdue fees are de minimis—i.e., not large enough to affect the country's ability to tap external financing.

[35] Payments Arrears in Current International Transactions, October 1970.

[36] For the World Bank, this treatment is based on the 1989 IMF-World Bank Concordat, Bank-Fund Collaboration in Assisting Member Countries, March 1989.

Figure 1. Decision Tree Summarizing the Current Multilateral NTP



LENDING INTO ARREARS POLICY

17. Fund staff reviewed 30 sovereign debt restructuring cases involving private-sector creditors since 2002 and reached out to stakeholders in early 2021. Staff reviewed all preemptive and post-default PSIs that occurred in the context of financing from the Fund (including both Fund-supported programs and emergency financing requests), and four cases without a Fund arrangement, since 2002 (Figure 2, Annex II).[37, 38] In addition, staff held consultations with

[37] The preemptive debt restructuring cases include Chad (2015), Chad (2018), Cyprus (2013), Ecuador (2020), Greece (2012), Grenada (2005), Jamaica (2010), Jamaica (2013), Moldova (2002), Mongolia (2018), Mozambique (2016), Nicaragua (2003), Nicaragua (2008), Ukraine (2015), and Uruguay (2003), all with a Fund arrangement. In addition, staff reviewed the preemptive PSIs of Belize in 2007, 2013, and 2017 outside the context of a Fund arrangement. The post-default cases, subject to the LIA policy, include, Argentina (2005/2010), Barbados (2019), Côte d'Ivoire (2010), Dominica (2006), Dominican Republic (2005), Grenada (2015), Iraq (2006), Mozambique (2019), Republic of Congo (ongoing), Serbia and Montenegro (2010), Serbia and Montenegro (2005), Seychelles (2010), St. Kitts and Nevis (2012), and Suriname (ongoing). Staff also reviewed the post-default restructuring in Argentina (2020), outside a Fund-supported program. Separately, the LIA policy was applied in a number of cases that did not involve a significant PSI, including cases involving legacy claims from an earlier PSI (e.g., Argentina, 2018), and cases where PSI represented a small share of overall debt relief (e.g., Antigua and Barbuda, 2010), or no PSI was envisaged (e.g., Gabon, 2017).

[38] Sovereign arrears to private creditors may arise for reasons unrelated to the need for debt restructuring, such as administrative issues on the debtor side and/or difficulties in affecting payments. In such cases, in practice, the standard "good faith" principles have been applied to the extent relevant as the debtor needs to engage its creditor(s) to resolve the arrears. Where payments are in arrears due to factors outside the debtor's control, such as

(continued)

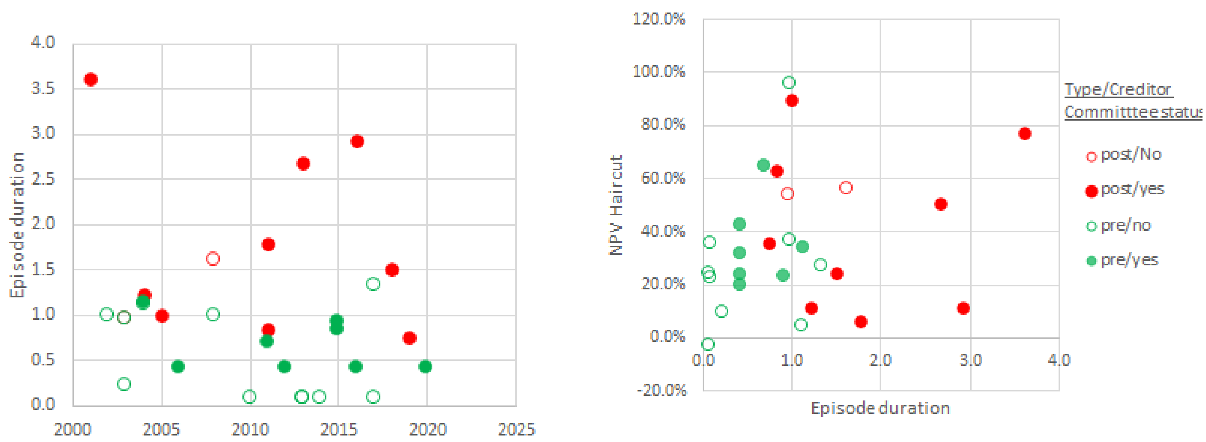
stakeholders representing a variety of private sector investors, interest groups, financial and legal advisors, IFIs, and public-sector officials and representatives.

A. Review of Post-Default Debt Restructuring Cases Since 2002

Figure 2. Outcomes of Preemptive and Post-Default Debt Restructuring since 2002

a. By Duration and Year of Debt Restructuring

b. By Duration and NPV Haircut



Sources: Staff reports and media reports; Asonuma, Niepelt and Ranciere (2018), Asonuma and Trebesch (2016), Cruces and Trebesch (2013), Das, Papaioannou and Trebesch (2012), Park and Samples (2021).

Notes: Both figures exclude one outlier (Serbia, 1992, post-default, with committee, 12.1 year duration) and the (still-ongoing) debt restructurings in the Republic of Congo and Suriname. Nicaragua (2003) and Chad (2015) are also excluded from Figure 2.b, as NPV haircut estimates are not available.

18. **In most post-default debt restructuring cases reviewed, arrears were resolved shortly after the successful completion of the debt exchange.** Most post-default debt restructurings during the review period had either full or very high creditor participation rates (in some instances only after the application of Collective Action Clauses (CACs))see Annex II. When full participation was not initially achieved, several countries opted to clear the arrears to remaining hold-outs. The main exceptions involving more protracted arrears to hold-outs were Argentina and Iraq following their debt restructurings in 2005 and 2006, respectively. In Argentina, the 2005 exchange achieved only 76 percent participation, with additional creditors participating in a reopened exchange in 2010 and a further settlement with most remaining hold-outs in 2016, but US$1.2 billion of arrears to residual hold-outs remained outstanding by the time of the 2018 Stand-By Arrangement (SBA). Iraq's initial (2006) debt exchange attracted higher participation (96 percent), and a reopening of

international sanctions, the policy was generally considered met and the Fund could lend when payments were made into escrow. This approach has been taken in cases where arrears have accumulated to official creditors due to sanctions or the lack of a counterpart on the creditor side (e.g., Mali, 2013; Honduras, 2011).

the exchange in 2008 resolved a further US$500m of arrears, but some residual arrears remained until after the conclusion of the 2010 SBA.[39]

19. Stakeholders generally found the LIA policy to be broadly appropriate. In general, the Fund's involvement was welcomed, as it was viewed to enhance the credibility of the debt restructuring process, and the LIA policy's good faith requirement incentivizes debtors to engage with creditors in a timely and constructive manner. That said, there was some criticism of the implementation of the "good faith" requirement, with some stakeholders arguing that a higher bar would be appropriate, while others contended that the Fund should not try to referee the process of debtor-creditor engagement. Stakeholders also noted that every debt restructuring poses unique challenges and that the precise modalities of creditor-debtor engagement can vary. Hence, it was largely acknowledged that the current policy, which allows for a flexible case-by-case approach, seems appropriate. However, a few issues were noted, as described below.

Early Dialogue

20. Dialogue with private creditors typically began much earlier, and the completion of discussions, was faster in preemptive than post-default cases. The average time between the announcement of the debt restructuring and the start of dialogue with private creditors in preemptive cases was two months, less than half the average time observed in post-default cases (five months). Overall, the duration varied more among post-default cases: while some debtors initiated negotiations almost immediately, others kept creditors waiting for over a year. Similarly, the average time between announcement and the completion of the debt restructuring in preemptive cases was much shorter, only about a third of the average time for post-default cases. This difference could reflect the complexity of some post-default cases (i.e., a selection effect: more complex cases are more likely to both involve default and take longer to resolve), but also stronger incentives to reach an agreement in preemptive cases due to the threat of a default. However, as further described below, there is no evidence to suggest there were substantial differences in the "quality" or the form of dialogue between the two cases.

Form of Engagement

21. In the cases reviewed, creditor committees were somewhat more common in post-default cases, but there was no clear relationship between the existence of a recognized creditor committee and the duration of debt restructurings. Committees appear to have been formed more frequently in post-default cases, including around 80 percent of cases reviewed, compared to just under half in preemptive debt restructurings. In post-default cases, the duration of the debt restructuring was somewhat longer with a committee relative to those conducted by

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[39] Commercial creditor participation in the HIPC Initiative has been weak, and there are several ongoing lawsuits. See Table AIII16 in the Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI)—Statistical Update, August 2019.Application of the LIA policy has been attenuated in Fund arrangements constituting the track record towards the HIPC Completion Point. In that context, the requirement of good faith efforts has been essentially satisfied by the member communicating with, and ultimately offering HIPC terms, to creditors.

means of bilateral dialogue. However, causality is not clear, since creditors may have stronger incentives to form committees in complex/difficult debt restructurings.

22. High participation was also achieved in the absence of creditor committees. In the cases reviewed, overall creditor participation levels were high, both in preemptive and post-default cases, and the existence of a creditor committee did not seem to have had much impact.

23. The lack of a distinct link between creditor committees and creditor participation was mirrored in stakeholders' call for a case-by-case approach. There was consensus among stakeholders that creditor committees can be useful, and strong support for engagement with creditor committees where they exist. However, committees were not seen as a prerequisite for efficiency, and other forms of dialogue, including bilateral negotiations or with facilitating agents, can also be effective depending on the types of claims involved. Stakeholders noted that every debt restructuring poses unique challenges, and the precise modalities of debtor-creditor engagement can, and should, vary accordingly; that timely engagement rather than its form is paramount; that forming committees also comes with monetary costs and other complications that may prevent some creditors from participating; and that high participation has also been achieved without committees.

24. In practice, while debtors generally engaged with creditor committees, very few bonds include clauses requiring them to do so. The inclusion of such creditor engagement clauses has been advocated by the Institute of International Finance (IIF), and they are included as optional clauses in the form of enhanced CACs published by the International Capital Markets Association (ICMA). A frequent argument is that some creditors, such as some asset managers acting on behalf of bondholders, do not have budgets for covering committee costs, leading to less representative committees (or no committees at all). On this basis, some stakeholders have also argued that Fund policy should encourage creditor engagement clauses, which generally include provisions obligating debtors to pay for creditor committee costs.[40] During the 2014 Executive Board's discussion of the ICMA model clauses on CACs, the Executive Board did not endorse creditor engagement clauses, leaving the modality of creditor engagement and related fees for the debtor and its creditors to agree.[41] Staff sees no reason to recommend a change in this position.

25. Stakeholders argued—and staff agrees—that the "complexity" limitation for creditor committees under the LIA (see Box 1) should be dropped, while cautioning that determinations of committee "representativeness" need to be case specific. Stakeholders recommended engagement with creditor committees more broadly, noting that whether a case is "complex" could be regarded as too subjective. Further, stakeholders generally recognized that it

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[40] See DeSieno (2016) for a statement of this argument. However, to the extent that there is an efficiency argument for debtor funding of committee costs (such as a coordination failure on the side of creditors), nothing prevents the debtor from offering such funding. To the extent that there is not, such funding would not be in the interest of the debtor (nor possibly that of some creditors), and Fund policy requiring the debtor to shoulder this funding would be inappropriate.

[41] See Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring, Minutes of Executive Board Meeting 14/92-2, October 2014.

would be difficult to objectively define "representativeness," which has several dimensions and could depend on the debt portfolio to be restructured (see Box 3). More broadly, they were of the view that the Fund should not become overly prescriptive on *de minimis* thresholds, as what matters for the sovereign is to find a counterpart whose interests are broadly aligned with most creditors. It should be anticipated that in some cases there would be multiple committees, and in this case, it was suggested that creditor committees could organize themselves so that the debtor would engage with a steering committee. While some stakeholders expressed concern with the splitting of creditors into several committees, others argued that the existence of multiple committees did not prevent creditors from reaching an agreement with the sovereign. Indeed, recent debt restructurings with Argentina (2020) and Ecuador (2020) both involved multiple committees.

Box 3. Argentina and the 2004 Global Committee of Argentina Bondholders (GCAB)

Whether a creditor committee was "representative" was explored in depth in the case of Argentina in the early 2000s. Argentina announced a default on its external debt in December 2001 and the Fund approved two SBAs during the course of its debt restructuring.[1] Several creditor committees were formed representing different interests, and a "global" creditor committee, the Global Committee of Argentina Bondholders (GCAB), was ultimately established on January 12, 2004, shortly before the first review under the second SBA.[2] Disagreements over the extent of Argentina's engagement with creditors under the LIA policy delayed completion of that review, and the staff report pointedly highlighted the importance of deepening exchanges with creditors going forward and assessing the representativeness of GCAB.[3] In early March 2004, staff sought guidance from the Executive Board in an informal session on the proposed assessment that GCAB was "representative" based on criteria laid out for the Executive Board's consideration.[4] During the informal session, the Argentine authorities, supported by several Executive Directors, argued strongly that the complexity of the case precluded the formation of a single representative creditor committee. In particular, the authorities argued that GCAB did not include important constituencies of bondholders, there was inadequate verification of the bond holdings the committee members claimed to represent, and some committee members had previously not acted in good faith. Ultimately, in line with staff's recommendation, the Executive Board advised that GCAB was a representative committee, and the authorities agreed to hold negotiations with GCAB and other creditor groups.[5]

The conclusion that GCAB was representative was based on the following facts: (1) GCAB appeared to represent the creditors it purported to, with most support evidenced by formal, documented mandates, and the remainder based on "informal, but customary, procedures followed in the relevant jurisdictions"; (2) GCAB's Steering Committee represented holders of approximately $35 billion of eligible bonds, accounting for approximately 89 percent of eligible bonds identified as held outside of Argentina, or approximately 43 percent of all eligible bonds.[6] Staff also observed that membership was open to any major non-litigating creditors, and included non-Argentine institutional and retail creditors from a variety of jurisdictions.[7] It was noted, however, that while GCAB had issued invitation letters to Argentine investor groups, no Argentine institutional investors had joined, having determined that their interests were substantially different from those of GCAB members. In assessing that GCAB was "representative" despite this absence, staff noted that (1) one group should not have effective veto power over the formation of a representative creditor committee; (2) the absent group had been invited to join; (3) litigation precluded a subset of the absent group from joining; and (4) a finding that the GCAB is representative would not prevent the authorities from engaging directly with non-participating creditors.[8]

Box 3. Argentina and the 2004 Global Committee of Argentina Bondholders (GCAB) (concluded)

[1] Under the first arrangement, approved in January 2003, three reviews were completed. Under the second, approved in September 2003, two reviews were completed.

[2] See, Argentina—Second Review Under the Stand-By Arrangement and Requests for Modification and Waiver of Performance Criteria, July 2004 at para. 7 (hereinafter, "Second Review").

[3] Argentina—First Review Under the Stand-By Arrangement and Request for Waiver of Nonobservance and Applicability of Performance Criteria, January 2004 at paras. 25-26

[4] Argentina - Issues Related to Establishment of a Creditor's Committee Under the Fund's Policy on Lending into Arrears to Private Creditors, March 2004 (hereinafter, "Creditor Committee Issues").

[5] Second Review at paras. 7, 37, 39 and Section E; Creditor Committee Issues at Annex II. See also Decision No. 13214, adopted March 22, 2004 (completing second review).

[6] Creditor Committee Issues at paras. 8, 10.

[7] Creditor Committee Issues at Annex I.

[8] Creditor Committee Issues at paras. 10-12.

Information Sharing and Opportunity for Input

26. In both preemptive and post-default cases reviewed, debtors routinely shared non-confidential information, and creditors appeared to have been given an opportunity to give input on the design of the debt restructuring. Staff reports indicate that non-confidential information was generally shared by the debtor with its creditors. This was also recognized by private creditors, although they noted that some information that they found essential, notably the full set of assumptions underlying the debt sustainability analysis, are not typically shared. Although staff reports are rarely explicit on the exact details of interactions with creditors, in most cases, this information sharing by debtors seems to have also lent creditors an opportunity to provide input on the design of debt restructuring instruments.

27. Stakeholders called for updates to the expectations for information sharing under "good faith" to reflect developments since this principle was defined. In terms of information sharing, private creditors suggested deleting the term "non-confidential" after "relevant". They consider that the term "relevant" alone would be more descriptive and coherent in practice. In the context of the LIA policy, information sharing is divided into non-confidential information, which the debtor should share with all creditors, and confidential information, which the debtor only needs to share in the context of a formal negotiating framework subject to safeguards. In this regard, "confidential" refers to "market sensitive" information, the sharing of which is regulated by securities laws and restricts the trading of securities. Private creditors pointed to two problems with the current LIA policy's treatment of information: First, the terms "confidential" and "non-confidential" can be misunderstood. In particular, debtors may hide behind the principle that only non-confidential information is to be shared with all creditors, by defining all sorts of information that is actually not market sensitive as "confidential". Second, creditor committee members may want to continue trading while they are negotiating. However, if they receive confidential (market

sensitive) information via the committee, they may violate securities law if they traded. Private creditors further asserted that they have developed mechanisms for sharing market sensitive information consistent with that framework. In terms of relevant information, participants mentioned that the following would be important: (i) the exchange of current macroeconomic and debt data, (ii) disclosure of the proposed treatment for different creditor classes, and (iii) transparency around macro policy assumptions (to the extent such information can be disclosed).

Flexibility in Emergency Financing Cases

28. While the LIA policy applies flexibly in emergency financing situations, in practice this flexibility appears not to have been needed in the cases reviewed. Four emergency financing requests involving LIA were identified,[42] but in each case the debtor had taken actions that were sufficient to support a determination that the authorities were engaged in "good faith" negotiations in line with the LIA policy.

B. Review of Application of LIA Policy to Jurisdictional Arrears

29. There have been few cases where the LIA policy has applied to non-sovereign arrears that arose because of the imposition of exchange controls (jurisdictional arrears). While jurisdictional arrears were the sole focus of the NTP in its original formulation (Annex III), such arrears now constitute only a small subset of cases to which the LIA policy applies. Staff identified three such cases since 2002: Iceland (2008); Latvia (2008); and São Tomé and Príncipe (2019). In each case, the LIA policy was applied to require both the member to make a good faith effort to facilitate a collaborative agreement between private debtors and creditors on the resolution of arrears and the existence of good prospects for the removal of the exchange controls giving rise to the arrears. Exchange controls were removed in both Iceland and Latvia, leading to a resolution of the arrears. Exchange controls remain in São Tomé and Príncipe, and the Executive Board has approved their temporary retention under the ongoing Fund-supported program.

30. Staff proposes no amendments to the LIA policy with respect to jurisdictional arrears. In this small set of cases, the LIA policy continues to help draw attention to the issue of arrears arising from the imposition of exchange controls, which continue to be an important part of the Fund's mandate. The LIA policy operates in tandem with Article VIII, Section 2(a) to convey a consistent message on the need to eliminate exchange controls—and their consequent arrears—to the extent possible.

[42] Iraq (EPCA, 2006), Mali (2012, RCF), Ecuador (2016, RFI), Mozambique (2019, RCF).

C. Recommendations

31. Overall, staff considers the LIA policy to be well balanced and that there is no need for a major overhaul of the policy. However, some amendments, and updates are warranted, given the experience gained and the developments observed over the last 20 years of PSI.

Update Elements of "Good Faith" Engagement

32. The principles for assessing "good faith" engagement outlined in 2002 remain broadly appropriate but could be amended, updated, and sharpened in several respects:

- **To provide guidance on what constitutes "relevant" information, with a focus on debt transparency.** Specifically, staff proposes that the Fund specify that the relevant information that should generally be shared with creditors would include a comprehensive picture of the government debt stock and its terms (in the aggregate) in line with the recent changes adopted under the Fund's Debt Limits Policy (DLP).[43] The suggested elements of this disclosure could be aligned with what the member would/could be required to disclose in Fund program documents under the DLP (Box 4): creditor composition, major subcategories of instruments (with information on the main financial terms), upcoming debt service, and collateralized debt.[44, 45]

Box 4. Other Fund Workstreams on Debt Transparency

The Fund is addressing the need to support debt transparency through ongoing reforms to the policy frameworks for both program conditionality and surveillance:

- The recent reform of the Debt Limits Policy (DLP) introduces an explicit expectation that critical debt data disclosure gaps be addressed upfront in Fund-supported programs that include debt limits. The new DLP also introduces a new standardized debt holder profile table, to be included in all Fund-program documents. Similarly, the Fund introduced new safeguards requirements for access to the resources of the Poverty Reduction and Growth Trust (PRGT) in March 2021, including a requirement for enhanced discussion of the structure of public debt for programs involving high access and for countries whose external risk rating is 'high' or 'in debt distress'.
- The Fund is also considering expanding debt reporting requirements in the review of the data provision to the Fund for surveillance purposes to better identify fiscal risks. Recent updates to the Fund's Debt Sustainability Analysis (DSA) frameworks also address debt coverage and disclosure.

[43] Reform of the Policy on Public Debt Limits in IMF-Supported Programs, November 2020.

[44] Guidance Note on Implementing the Debt Limits Policy in Fund Supported Programs, May 2021.

[45] It would be expected that aggregated debt data would include all relevant debt. To the extent that certain debt is covered by confidentiality clauses, a full breakdown may not be feasible and only the sharing of relevant aggregated data would be expected. It is recognized that data reconciliation may mean that there may be delays in sharing final numbers.

Box 4. Other Fund Workstreams on Debt Transparency (concluded)

- The 2017 Review of the IMF-World Bank Debt Sustainability Framework for Low Income Countries features an expectation that DSAs should have a near-complete coverage of public debt, supported by standardized reporting of the sub-sectors included and excluded from the DSA and a new contingent liability stress test to assess risks from omitted sectors.[1]

The 2021 Review of the Debt Sustainability Framework for Market-Access Countries enhances reporting of debt profile vulnerabilities, including through a breakdown of debt by instrument type and by holder profile.[2] Bank and Fund staff are supporting official and private sector transparency initiatives:

- **For official creditors, World Bank Group and Fund staff are supporting G20 efforts on sustainable finance and transparency.** The G20's Operational Guidelines for Sustainable Financing—Diagnostic Tool identifies shortcomings in official creditor practices including on transparency, and a second round of voluntary self-assessment using the Diagnostic Tool is currently under way.[3]
- **For private creditors, Fund staff are supporting IIF/OECD work on debt transparency.** Staff participate in a user's group and the Advisory Board involving the World Bank, Fund, Bank for International Settlement (BIS), and the IIF to support Organization for Economic Co-operation and Development's (OECD) development and hosting of a data repository, analysis and reporting of private sector foreign-currency lending to sovereigns (or borrowers with public guarantees) in PRGT-eligible countries.
- **The Fund and World Bank are actively working to address debt vulnerabilities in LICs with the implementation of a multi-pronged approach (MPA) since fall 2018.** The MPA covers efforts to support improved debt monitoring, wider debt data coverage and transparency, stronger debt management capacity building, and outreach to creditors.
- **The ongoing Tenth Review of the IMF's Data Standards Initiatives also aims to foster data transparency including regarding debt data**. It builds on the current framework for data dissemination by encouraging more granular publication of debt data, focusing on debt breakdowns by creditor and creditor type.
- **Finally, the Fund's work program includes an Executive Board paper to better understand the incentives for limited debt transparency by debtors and creditors.** The paper envisages to focus on policies, including domestic legal frameworks, international standards, and best practices in debt data recording, reporting and disclosure that could lead to greater debt transparency.

[1] Review of the Debt Sustainability Framework for Low Income Countries: Proposed Reforms, October 2017.

[2] Review of the Debt Sustainability Framework for Market Access Countries, February 2021.

[3] G20 Operational Guidelines for Sustainable Financing—Diagnostic Tool, November 2019.

- **To replace the two-track approach on confidential (formal negotiating framework) and non-confidential information (all cases) with an expectation to share all *relevant* information with creditors.** As noted above, the distinction between confidential (i.e., market sensitive) and non-confidential information is no longer meaningful; private creditors have developed modalities to deal with market sensitive information even outside of a formal negotiating framework, while in some cases members of a creditor committee may prefer not to be privy to confidential information to avoid being subject to trading restrictions. As such,

staff proposes that the existing two-track approach be replaced with a generalized expectation that the creditor should share relevant information (thereby eliminating the formal negotiating framework, including the expectation to enter into formal negotiations with a representative committee if timely formed in complex cases), subject to appropriate safeguards agreed between the parties where this information is market sensitive. This would also bring the LIA policy into closer alignment with "good faith" under the LIOA policy, which includes sharing of "relevant information."[46]

- **To add the element that the debtor's offer should be consistent with the parameters of the Fund-supported program.** The existing "good faith" principles focus on procedural elements of debtor-creditor engagement, but it is important to recognize that in practice, good faith engagement also depends on the financial terms of a debt restructuring proposal. In particular, "good faith" engagement would require that a debt restructuring proposal—to the extent one is made before the Executive Board meeting, which may not always be the case—be broadly in line with what is needed to restore debt sustainability, as reflected in the parameters of the Fund-supported program. While this issue is currently addressed indirectly by the Fund's other policies on debt sustainability,[47] staff proposes to explicitly include an expectation as a fourth guiding principle of good faith, that any debt restructuring proposal offered by the debtor should be consistent with the parameters of the Fund-supported program. Again, this amendment would bring the LIA policy into closer alignment with the LIOA policy and would be consistent with the need to ensure that a debt restructuring will restore sustainability and has a reasonable prospect of succeeding.

- **To play a stronger role in encouraging early dialogue and clear communication by the debtor on the perimeter of claims of a PSI.** Given the many unknowns private creditors have to factor in during a debt restructuring, the sooner the debtor can specify the perimeter of claims subject to PSI (including claims held on non-government public sector entities), the sooner those creditors can make progress toward an agreement among themselves and with the debtor. Although providing this clarity is the debtor's responsibility, the Fund could establish an expectation on the debtor to do this at the outset of the debt restructuring process. This expectation will also help the Fund establish the requisite assurances under the financing assurances or LIA policy that the debt restructuring will restore debt sustainability. However, this would need to be carefully balanced against the Fund's approach not to micromanage the debt restructuring process. Beyond establishing an expectation as part of the assessment of good faith, it would seem the Fund cannot (and should not) do more. The perimeter of claims that a government chooses to set for a PSI and/or the terms demanded from various private creditors is not something the Fund should interfere in. Creditors can exert

[46] For the avoidance of doubt, any information that the Fund produces (such as a DSA or a set of macroeconomic projections against which policies are assessed) continues to be confidential and subject to the Fund's confidentiality rules, which prohibit sharing unless the Fund has published it or consented to its disclosure subject to safeguards.

[47] For example, an offer that falls short of program parameters would not typically be consistent with an assessment that debt sustainability will be restored, while a proposal that is seeking "excessive" relief (e.g., a large NPV haircut) would undermine the high creditor participation needed.

leverage on the debtors through several channels, and it is not for the Fund to get involved in debt restructuring negotiations (except that for instance, Fund staff could, at the member's request, explain the Fund's policies and/or the assumptions underlying the member's macro forecast and Fund program parameters as well as the DSA).

Sharpen the Expected Engagement with Creditor Committees in Two Respects

33. As noted above, staff recommends that the expectation of engagement with a creditor committee *under a formal negotiating framework* be eliminated. However, as a factor staff would consider in assessing good faith, a member would still be expected to engage with a creditor committee or creditor committees when the criteria under the LIA policy are met, with the two below amendments.

34. Because the "complexity" of a case is difficult to determine and not a critical element, staff recommends that this element not be retained under the LIA policy. The LIA policy currently sets the expectation that engagement with creditor committees should only occur "when warranted by the complexity of the case." Three reasons underpin staff's recommendation. First, given that each debt restructuring is unique and presents its own challenges, it is difficult to judge in practice whether one is truly more complex than another. Indeed, even where creditor committees were considered representative in Fund-supported programs, there has been very little discussion of whether the complexity of the case merited such a committee. Second, enforcement of the "complexity" requirement could undermine the objective of encouraging debtor-creditor engagement. In other words, the Fund should not sanction a debtor's disregard of a representative creditor committee simply because a debt restructuring is not deemed complex enough. Third, the factors for determining complexity suggested by the 2002 Board Paper— the number and diversity of creditors, the range of instruments covered by the debt restructuring, the prevalence of inter-creditor equity issues, and the size of the prospective haircut—are generally echoed in the determination of whether a creditor committee is sufficiently representative.[48] Thus, it is somewhat redundant to require a judgment on complexity. Given the underlying objective of furthering debtor-creditor engagement and the overlap between the elements, staff considers that it is not necessary for the Fund to judge whether the complexity of a case merits the use of a creditor committee.

35. However, staff recommends retaining the expectation that the debtor would engage with a representative creditor committee or representative creditor committees; the below factors could be considered in determining "representativeness."[49] Specifically, staff proposes that a representative creditor committee may be expected:

[48] Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion, July 2002.

[49] The Executive Board has already provided factors that can be considered flexibly on a case-by-case basis. While declining to set a numerical threshold for determining representativeness, the 2002 paper suggested that consideration could be given on a case-by-case basis to factors such as (a) the proportion of principal held by

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- To represent a substantial portion of the principal covered by the debt restructuring. While staff continues to consider that it is not appropriate to set binding numerical thresholds, as case-specific circumstances can vary significantly (see Annex II), it would appear useful to specify that in cases where bonds contain aggregated CACs,[50] creditor committees representing a share of claims sufficient to block the activation of these CACs would typically be considered to meet this test.

- To reflect the diverse financial and economic interests of the creditors whose claims are to be restructured—for example, in terms of the different instruments to be restructured, geographical location, and nature of the holders (e.g., in terms of retail and institutional investors, large and small bondholders, special purpose vehicles with control or ownership of bonds, influential financial institutions, and hold-to-maturity and distressed debt purchasers). However, no group's refusal to join the committee should act as a veto on the formation of a representative committee.

- To have the support of the creditor groups that it purports to represent. As noted in the 2002 Board Paper, because committees are expected to function in a purely advisory capacity under the LIA policy, the verification of claims as a precondition for negotiations has not been a serious issue, as reputational risk to the participants has generally disciplined the process.[51] However, direct participation by the largest creditors could be encouraged. For creditor representatives, the Fund could consider whether there is evidence that the participant represents the group it purports to represent, including in cases where some creditors are constrained in their ability to participate directly.

36. In cases where creditors form multiple committees, some engagement with committees that individually or collectively meet the above factors would generally be warranted. Entering into detailed negotiations with multiple committees may not always be feasible, nor may it be necessary in the case of smaller, non-representative committees. In such cases, the debtor may prefer to engage with the committee that appears most representative (or if relevant, a steering group with representation from the different committees). However, where other committees hold a sizeable share of claims, debtors could still be expected to engage with those committees, including to supply relevant information at the committees' request. This would particularly be the case when there are several sizeable committees of which none is individually representative, but which are collectively representative.

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creditors that have signaled their support for the committee, and (b) the coverage of major types of creditors represented in the committee. *Id.* at para. 44 (noting also that participation might be expected to be higher among institutional rather than retail investors). In discussing this criterion, Executive Directors recognized the importance of flexibility and judgment. See The Acting Chair's Summing Up—Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion, September 2002.

[50] Aggregated thresholds for approval in enhanced CACs are 66 2/3 percent across series (in two-limb aggregated voting) or 75 percent across series for single-limb aggregated voting.

[51] Fund Policy on Lending into Arrears to Private Creditors - Further Consideration of the Good Faith Criterion, July 2002.

Restate the Use of Flexibility in Emergency Financing Cases

37. Staff proposes to restate the circumstances in which the LIA policy can be applied flexibly for emergency financing requests in line with the LIOA policy. While the review indicates that the need for flexibility under the LIA policy has so far been limited, staff continues to see circumstances in which this could become relevant in the future. In particular, it would appear sensible to align the expectations for the use of flexibility with the LIOA policy, under which flexibility is reserved for emergency situations, such as in the aftermath of a natural disaster, where the extraordinary demands on the affected government are such that there is insufficient time for it, as the debtor, to undertake good faith efforts to reach agreement with its creditors.[52] In addition, it would be expected that the Fund's support provided to the debtor in such cases would help advance normalization of relations with private creditors and the resolution of arrears, so that the approval of any subsequent Fund arrangement for the member would again be subject to the LIA policy.

Provide Further Guidance on Implementation in Staff Reports

38. Staff will provide more precise guidance on how to assess, and document in the staff report compliance with the good faith criterion. Enhanced transparency and evenhandedness can be better achieved through standardized documentation in staff reports. Staff will also provide further guidance on the Fund's role in sovereign debt restructuring.

LIA policy versus IIF Principles for Stable Capital Flows and Fair Debt Restructuring

39. While staff supports many elements of the IIF Principles (the "Principles")—and there are significant overlaps between the Fund's current LIA policy and the Principles as well as their Addendum—there are also important differences (Box 5). Therefore, staff continues to take the view that it would not be appropriate to endorse the IIF Principles and their Addendum.[53] Staff also understands that the Principles are being reviewed to consolidate and update them, and staff has been in contact with the IIF. First, the Principles unreservedly encourage early negotiations with a committee after a default, while the current LIA policy provides for formal negotiations only if the case is complex, the committee is representative, and has been established on a timely basis. Second, the Principles call on the resumption of partial debt service and recommend including official bilateral creditors in the debt restructuring while the LIA policy remains silent on these issues. Third, in contrast to the Addendum to the Principles, the Fund's policy does not foresee a formal involvement of the private sector in DSA preparations and leaves the specifics of creditor committee design, including costs, as well as the debt restructuring strategy and perimeter to negotiations between creditors and debtors.

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[52] The requirements of debt sustainability and any other applicable Fund policies continue to apply.

[53] See also: Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework, April 2013.

Box 5. IIF Principles for Stable Capital Flows and Fair Debt Restructuring

- **The Institute of International Finance's (IIF) "Principles for Stable Capital Flows and Fair Debt Restructuring" (the "Principles") establish best practices for the consultation between debtors and creditors in sovereign debt restructurings.** The Principles were announced in the G20 Berlin Communique in 2004 and have since been applied in several debt restructuring operations. The Fund has neither been involved in the Principles' establishment nor formally endorsed them.

- **The Principles are non-binding rules aimed at facilitating a voluntary, market-based debt restructuring process based on good faith and ensuring the fair treatment of all affected creditors.** They are used on a case-by-case basis and apply equally to preemptive and post-default debt restructurings. They consist of the following four key principles, which are further broken down into specific rules of conduct that build on international best practices:

  - Transparency and timely flow of information: The Principles call on debtors to disclose relevant information to creditors, including specific disclosure in a debt restructuring context relating to maturity and interest rate structures, the proposed treatment of such obligations, and the central aspects of economic policies and programs.

  - Close debtor-creditor dialogue and cooperation to avoid debt restructuring: Debtors and creditors should be in a regular dialogue regarding information and data on key economic and financial policies and performance, notably through investor relation channels, policy action and feedback, as well as consultations. In a debt restructuring, creditors should consider appropriate requests for the voluntary, temporary rollover of short-term maturities on public and private sector obligations, if necessary to avoid a broad debt restructuring.

  - Good-faith actions: Creditors and debtors should engage in a debt restructuring that is voluntary and based on good faith, and cooperate in order to identify the best means to bring the debtor member back to a sustainable BOP position while preserving and protecting asset value during debt restructurings. The Principles emphasize the sanctity of contracts, call on debtors and creditors to rely upon the Fund in its traditional role, and support the establishment of creditor committees, the costs of which are usually borne by the debtor member.

  - Fair treatment: Borrowing countries should avoid unfair discrimination among affected creditors.

- **Following the Greek sovereign debt restructuring of 2012, the IIF published an Addendum to the Principles (the "Addendum") to make further recommendations taking account of specific issues in restructurings of mature market countries' debts.** The Addendum *inter alia* clarifies the meaning of "good faith actions", calls for early restoration of market access, and recommends early discussions with representative creditor committees as well as greater private sector involvement in DSAs.

PREEMPTIVE DEBT RESTRUCTURING PRACTICE

A. Review of Practice in Preemptive Debt Restructuring Cases

40. In general, preemptive debt restructurings are associated with better outcomes for the debtor member and creditors.[54] These debt restructurings tend to be shorter in duration, achieve higher creditor participation, have lower haircuts, and lead to better post-restructuring growth outcomes to the debtor than post-default debt restructurings. As noted above, the Fund advises members to remain current on all debt obligations to the extent possible. Thus, where a debt restructuring is needed, a member should seek to initiate a preemptive debt restructuring and continue to service the original claims during the debt restructuring process. In the context of financial support from the Fund, avoiding a default is important both because a default may exacerbate the immediate economic and financial dislocation and because it may undermine the member's capacity to re-access international private capital markets in the medium term, which is a key requirement for Fund financing.

41. Unlike in post-default settings, where the LIA policy applies, the Fund does not have a formal policy linking Fund support to a specified standard for creditor engagement in preemptive debt restructuring negotiations. The LIA policy only tolerates arrears to private sector creditors in PSI cases under specific limited circumstances and motivates the standard for debtor-creditor engagement by focusing on the resolution of those arrears.[55] Absent arrears, however, this motivation for specifying a standard for engagement to guide the Fund's decision to lend does not apply. Furthermore, in 2002, staff expressed concern that establishment of a formal Fund framework establishing minimum engagement expectations would be too cumbersome in preemptive cases, running counter to the objective of swiftly concluding negotiations that would avert default.[56]

42. However, experience since 2002 indicates that debtor-creditor engagement in successful preemptive debt restructurings is similar to that in post-default debt restructurings. Since 2002, 20 preemptive sovereign debt restructuring episodes have taken place. The average time to conclude the preemptive operations ranged from 1 to 15 months with an average of 6.3 months (see Table 1). A review of cases since 2002 shows that creditor committees have been as frequent in preemptive as in post-default cases. Market participants have expressed

[54] See The International Architecture for Resolving Sovereign Debt Involving Private-Sector Creditors—Recent Developments, Challenges, And Reform Options, October 2020.

[55] "[Executive] Directors stressed that in promoting orderly financial relations, every effort must be made to avoid arrears, which could not be condoned or anticipated by the Fund in the design of programs. Nevertheless, an accumulation of arrears to banks may have to be tolerated where negotiations continue and the country's financing situation does not allow them to be avoided", Summing Up by the Chairman—Fund Involvement in the Debt Strategy, May 1989,at p. 4.

[56] Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion, July 2002.

the view that they consider preemptive cases with elevated debt vulnerabilities had a similar level of engagement as post-default cases.

Table 1. Episodes of Preemptive Restructuring of Public Marketable Debt, 2002-2021[1]

Country	Start of default or debt restructuring process[2, 3]	End of debt restructuring process[4]	Length of process (in months)	Presence of a committee	Participation rate (in percent)
Moldova	Jun-2002	Oct-2002	5	No	100
Uruguay	Mar-2003	May-2003	3	No	91
Nicaragua	Jul-2003	Jul-2003	1	No	100
Dominican Republic	Apr-2004	May-2005	14	No	97
Grenada	Oct-2004	Nov-2005	14	Yes	93
Belize	Aug-2006	Feb-2007	7	Yes	98.1
Nicaragua	Jun-2008	Jul-2008	1	No	100
Jamaica	Jan-2010	Feb-2010	1	No	99.2
Greece	Jul-2011	Mar-2012	9	Yes	96.9
Belize	Aug-2012	Mar-2013	6	Yes	100
Jamaica	Feb-2013	Mar-2013	1	No	99
Cyprus	Jun-2013	Jul-2013	1	No	100
Chad	Sep-2014	Dec-2015	15	No	100
Ukraine	Jan-2015	Dec-2015	10	Yes	100
Mozambique	Jun-2015	Apr-2016	10	Yes	85
Belize	Nov-2016	Mar-2017	4	Yes	100
Mongolia	Feb-2017	Mar-2017	1	No	90[5]
Chad	Feb-2017	Jun-2018	17	No	100
Ecuador	Mar-2020	Aug-2020	5	Yes	100

Sources: Das, Papaioannou and Trebesch (2012); Asonuma and Trebesch (2016); IMF (2015); IMF (2020); Moody's (2020); Asonuma and Joo (2020); IMF country reports; and country authorities' websites.

[1] Note: Ongoing cases as of February-2022 have been excluded.

[2] Restructurings are defined as "preemptive" if (i) no debt service payments are missed (no legal default) or (ii) some debt service payments are missed, but only temporarily and after the start of formal or informal negotiations with creditor representatives (no unilateral default). "Post-default" debt restructurings are all other cases, in which debt service payments are missed unilaterally and without the agreement of creditors.

[3] The start of a default/restructuring process is defined as the default month or the month in which a distressed debt restructuring was announced. When both a default and an announcement take place, the earliest date is used.

[4] The end of a debt restructuring is defined as the month of the final agreement or the implementation of the debt exchange.

[5] 83 percent participation rate of existing holders, or over 90 percent excluding US-based investors who could not participate for legal reasons.

43. On rare occasions, preemptive sovereign debt restructurings have also taken place outside Fund-supported programs. For example, the Fund played the role of an independent and

neutral party in Belize's 2007, 2013, 2016, and 2021 preemptive debt restructurings. The 2006 Article IV consultation documents and staff's DSA and cash flow analysis played a central role in setting the parameter for the 2007 debt restructuring. In December 2006, at the request of the Belizean authorities, the Fund's Managing Director issued an assessment letter to the international financial community, right after the exchange launch, encouraging high participation.[57] Similarly, Fund staff were in close contact with the authorities and financial advisors in the 2013 debt restructuring. Technical assistance on debt management also helped build relevant institutional capacity.

44. Fund policies and practices have helped promote engagement during preemptive sovereign debt restructurings. First, the current LIA policy incentivizes the debtor to engage with its creditors in preemptive situations given the knowledge that a post-default debt restructuring would carry strong expectations concerning the debtor through the LIA policy. Second, the Fund's current *practice* in preemptive debt restructuring cases, which requires a process that credibly delivers a debt restructuring outcome in line with program parameters, has generally looked to guiding principles for engagement broadly similar to those listed in Box 1 in order to assess the credibility of the process. Given that speed is of the essence to avoid a default, where conditionality has been employed in preemptive cases, the current practice has normally required debt operations to be completed or, if justified by the circumstances of the specific case, more advanced before approving the request for an arrangement than is typically the case in post-default settings. However, the application of this approach has varied in practice.[58]

B. Recommendations

45. Staff sees the current practice as broadly appropriate in preemptive debt restructuring cases. Any attempts to improve the status quo need to take into account that preemptive cases are different from post-default debt restructurings in that time is of the essence. It is in the interest of both the debtor and the creditors to avoid a default and the associated large costs and inefficiencies. Accordingly, any policy should continue to allow for flexibility such that its application does not result in a delay of the debt restructuring and the incurrence of arrears.

46. Staff nevertheless sees merit in codifying the existing practice into a Fund policy with some enhancements to guide creditors, debtors, and the Fund in preemptive debt restructuring cases and to enhance clarity, certainty, and transparency. Codifying the existing practice into a Fund policy amounts to a transparent commitment of the Fund to decide when a preemptive debt restructuring is credible taking into account a range of factors as discussed below. This can provide certainty to help guide creditors and debtor in their negotiations and accelerate their conclusion. The codification also creates an opportunity to highlight a particular ingredient of

[57] Belize - Assessment Letter for the International Financial Community, December 2006.

[58] In post-default cases, programs have generally allowed more time for the debt restructuring to be completed, with conditionality consisting of intermediate steps towards finalizing the debt operation. See: The Fund's Lending Framework and Sovereign Debt—Further Considerations, April 2015.

the preemptive debt restructuring process which the Fund has increasingly viewed as important: the need for debt transparency on the side of the debtor. It should be noted that, relative to the LIA policy that applies to post-default cases, the practice in preemptive cases provides fewer guiding principles and greater flexibility in order to encourage efficient resolution of debt issues without default.

Codification of Current Practice into a Fund Policy with Enhanced Debt Transparency

47. Staff recommends codifying the current practice into a Fund policy requiring that the Fund assesses that a credible process for debt restructuring is underway and such debt restructuring will likely deliver an outcome in line with program requirements. Relevant considerations to form such judgment would continue to include the engagement of legal and financial advisors by the member, the launching of consultations with creditors, and the design of the debt restructuring strategy, including the terms of the new instruments and use of inducements for creditor participation. To inform its judgment, staff may consider a range of factors, including (but not limited to) the stage of the negotiations, the private sectors' share of the overall financing envelope, and the strength of the creditors' position given, e.g., the existence of collateral.

48. In addition, staff recommends adding an expectation of enhanced transparency and information sharing. Staff proposes that, for the reasons explained in paragraph 32, the Fund policy on preemptive debt restructurings also include an expectation that relevant information—as defined under the LIA policy—be shared on a timely basis.

LENDING INTO OFFICIAL BILATERAL ARREARS

A. Review of Cases with Arrears to Official Bilateral Creditors Since 2015

49. Staff reviewed the 37 arrangements or outright disbursements during which arrears to official bilateral creditors arose since the establishment of the LIOA policy in 2015 (Table 2).[59] Several of these cases required the application of multiple strands of the LIOA policy over the course of the Fund-supported program.[60]

- Of the 37 cases, 11 had "non-OSI arrears"—i.e., the program anticipated full repayment of the claim without the need for a contribution from official bilateral creditors. In all such cases, the Fund was able to provide financing, as the creditors' Executive Directors acquiesced or did not object at the time of the Executive Board meetings. In these cases, staff has typically

[59] Where there is a representative Paris Club agreement and the member continues to make best efforts to conclude bilateral agreements, only the first arrangement after 2015 has been included.

[60] For example, in one case a creditor provided consent to proceed with a review under the arrangement; at the next review, however, the creditor did not provide such consent. Another example would be where arrears arose on claims that both pre-date and post-date a representative Paris Club agreement which are subject to the LIOA (former) and the NTP (latter).

complemented the debtors' efforts by reaching out to the creditors' Executive Director's office in advance.

- In 29 cases, there were arrears on claims where OSI was expected under the macro-framework. It was for these cases, where a debt restructuring is deemed necessary, that the LIOA policy was established to encourage collective action among official bilateral creditors and to ensure that the provision of Fund support is not held up by the unwillingness of hold-out creditors to join an effort that is supported by an adequately representative group of creditors. In all cases, the Fund was able to provide financing. Of these 29 cases, 14 had claims covered by a representative Paris Club agreement, allowing remaining arrears to official bilateral creditors to be deemed away. In 12 cases, creditors provided explicit consent to Fund financing despite the arrears. In Suriname (2021), the LIOA policy allowed the Fund to provide financing even before agreement on a restructuring was reached with all official bilateral creditors; China and India, which together account for a majority of official bilateral debt, provided consent to Fund financing despite the arrears, and restructuring discussions are ongoing.[61] The three criteria under the LIOA policy were only applied in seven cases involving four debtors; the criteria were judged to be met in each case. Of the seven cases, three involved a national-security dispute between the debtor and creditor and one involved non-recognition of the creditor government; these issues fall outside the influence of the arrears policies. In the remaining three cases, which involve two debtors and a single creditor, creditor consent was sought but not provided by the time of the relevant Executive Board meetings. Over the course of the arrangements, this was both due to the creditor ultimately providing no response at times,[62] as well as to affirmative objections from the creditor at other times.

Table 2. Arrears to Official Bilateral Creditors—Application of Arrears Policies

			OSI			
Debtor	**Facility, Approval**	**non-OSI**	**Representative Paris Club agreement**	**Consent**	**Three criteria**	**Emergency Financing**
Afghanistan	ECF, 2016		x			
Barbados	EFF, 2018			x		
Burkina Faso	ECF, 2016		x			
Central African Republic	ECF, 2019			x	x	
Central African Republic	ECF, 2017	x		x	x	
Chad	ECF 2017	x				
Chad	RCF, 2020	x				

[61] As described in Annex I, the application of the LIOA policy—including the receipt of consent—generally provides sufficient assurances to the Fund that debt sustainability will be restored with respect to the covered claims. Given case-specific circumstances, additional safeguards were considered important in Suriname: statements from the official creditors indicating their intent to work with Suriname on a restructuring that will restore debt sustainability, as well as commitments from the Surinamese authorities to only repay official and private creditors in line with program parameters.

[62] "Deemed consent" did not apply in these cases because the creditor authorities were responsive and sought additional time to consider the request, though they ultimately provided no substantive response.

Table 2. Arrears to Official Bilateral Creditors—Application of Arrears Policies (concluded)

Chad	ECF, 2021		x			
Comoros	RCF, 2020	x				
Dem. Rep. Of Congo	ECF, 2019		x	x		
Djibouti	RCF, 2020					x
Ethiopia	EFF/ECF, 2019		x			
Gabon	EFF, 2017	x				
Gabon	RFI, 2020	x				
The Gambia	RCF, 2017			x		x
The Gambia	ECF, 2020				x	
Grenada	ECF, 2016		x	x		
Grenada	RCF, 2020			x	x	x
Guinea	ECF, 2017		x			
Guinea	ECF, 2016	x				
Guinea-Bissau	ECF, 2016			x		
Guinea-Bissau	RCF, 2021	x		x		
Iraq	SBA, 2016		x			
Jamaica	EFF, 2016		x			
Jordan	EFF, 2016		x			
Mongolia	EFF, 2017			x		
Mozambique	RCF, 2019		x			
Mozambique	RCF, 2020	x				
Rep. of Congo	ECF, 2022			x		
Sao Tome and Principe	ECF, 2019	x	x			
Serbia	SBA, 2016		x			
Somalia	EFF/ECF, 2020		x			
Suriname	SBA, 2016	x				
Suriname	EFF, 2021			x		
Ukraine	EFF, 2016				x	
Ukraine	SBA, 2019				x	
Ukraine	SBA, 2020				x	

- Four cases involved OSI-related arrears in emergency financing requests under the RCF or RFI. One of these (Djibouti 2020) was determined to fit the exceptional circumstances under the LIOA policy that allowed flexible application: it advanced on the basis of the authorities' expected application for relief under the Debt Service Suspension Initiative (DSSI). In Grenada (2020), the flexibility was not used given that debtor-creditor discussions had already been long underway by the time of the request. Similarly, in The Gambia (2017) and Guinea-Bissau (2021), creditor consent was obtained given that arrears pre-dated HIPC and debt restructuring discussions were already underway.

B. Recommendations

50. The LIOA policy appears to have worked well. Importantly, arrears to hold-out official bilateral creditors have not prevented Fund financing, which is the main objective of the policy. Feedback from outreach to both debtor and creditor members has been overwhelmingly positive, indicating that the policy provides an opportunity for engagement on arrears and that it strikes the

right balance between discouraging arrears and preventing hold-out creditors from vetoing Fund financing. The fact that arrears have been addressed through collective action or debtor-creditor agreement in the large majority of cases is positive.[63] It is difficult to draw broad lessons from the few cases where the Fund has had to resort to applying the three criteria. Sovereign arrears however could only be fully resolved in a few cases (see Annex IV).

51. **Some stakeholders have asked for further clarification of the language on the LIOA policy's third criterion.** The summing up states that, the third criterion—i.e., whether the Fund's decision to lend into arrears to an official bilateral creditor would have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases—"would normally not be satisfied where the creditor or group of creditors that has not reached agreement with the debtor accounts for an adequately representative share."[64] This admonition is in line with the intended use of the LIOA policy to ensure Fund financing supported by "an adequately representative group of creditors" is not vetoed by "hold-out creditors."[65] In practical terms, the use of "normally" indicates some degree of discretion to rebut the presumption not to lend into arrears to a majority creditor or group of creditors. In this regard, any evaluation of this criterion in these exceptional circumstances should be in line with the Fund's mandate and based exclusively on a determination as to whether the Fund's decision to provide financing despite the arrears would have an undue negative effect on its ability to mobilize official financing packages in future cases. The Fund would still need to assess that the third criterion under the LIOA policy is satisfied. In general, however, a durable solution to a BOP problem that requires a debt restructuring is unlikely to be achievable without the participation of large creditors.

OSI-Related Arrears

52. **As to the treatment of arrears that persist over multiple Fund-supported programs, once a claim has been determined to be OSI related, such determination is permanent under the current policy.** The LIOA policy notes that "the regularization of arrears is an objective of any Fund-supported program and important for the functioning of the international financial system at large."[66] However, arrears occasionally persist beyond the length of a Fund-supported program and must again be addressed in the context of a successor arrangement. In such cases, the question arises as to whether the necessity for OSI must be assessed anew in the context of the new program. While the LIOA policy does not explicitly mention this, in practice, new Fund-supported programs have incorporated the assumption that old OSI-related claims would be restructured in line with the terms stipulated in the original Fund-supported program. The Fund took the same approach with respect to HIPC legacy arrears. The alternative approach would create perverse incentives: the prospect of having claims reclassified as non-OSI as the debtor's situation improves

[63] The ultimate resolution of arrears depends on the debtor and its creditors.

[64] The Chairman's Summing Up—Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors, December 2015.

[65] *Id.*

[66] *Id.*

could incentivize official creditors to hold-out for eventual full repayment, free riding on the creditors who accepted a debt restructuring. Staff therefore proposes to restate that, once a claim has been determined to be OSI related, such determination is permanent.[67] However, in line with current practice, a claim that was originally non-OSI related may be recategorized as OSI related if required by economic developments.

The Common Framework as a Potential New Representative Standing Forum

53. The Common Framework (CF) has arisen as a new modality for collective action among official bilateral creditors.[68] The CF is a set of principles and processes which the G20 countries and the Paris Club endorsed in November 2020 to facilitate timely and orderly debt treatment for 73 low-income countries eligible for the DSSI.[69, 70] However, with the first debt treatments under consideration, the CF may emerge as a commonly used approach for eligible members' debt treatments. As noted above in Box 2, the LIOA policy provides a special status only to the Paris Club—due to its status as a long-standing representative forum for official creditor coordination and its track record of support for Fund arrangements—such that adequately representative Paris Club agreements can "deem away" arrears to non-participating official creditors.[71] Thus, adequately representative CF treatments can only "deem away" arrears to non-participants when a Paris Club creditor participates (in such cases, both the non-Paris Club and Paris Club financing under the CF would count to determine representativeness, as is currently the case in Paris Club Plus treatments).

54. While the Executive Board has indicated an openness to according another "representative standing forum" a status under the LIOA policy equivalent to that of the Paris Club, it is currently uncertain how the CF and its role in the international sovereign debt architecture will evolve. As the CF comprises the main G20 creditors, the CF is representative. However, a new creditor committee is established in response to each request for a debt treatment, a process that requires case-by-case approvals from some official creditors. Moreover, unlike the Paris Club, the CF does not allow for a regular *ex ante* monitoring of developments in debtor members, which can facilitate timely financing assurances when needed. Further, at this time, a single country case (Chad[72]) has received official sector financing assurances under the CF, and the treatment is still to be implemented. To date, the CF has not been able to deliver financing

[67] Similarly, if arrears are deemed away on the basis that a Paris Club agreement is representative, there would be no need to reassess such representativeness in subsequent programs.

[68] Extraordinary G20 Finance Ministers and Central Bank Governors' Meeting, Statement, November 13, 2020.

[69] *Id.*

[70] Beaumont and Hakura (2021).

[71] The Chairman's Summing Up— Reforming the Fund's Policy on Non-toleration of Arrears to Official Creditors, December 2015.

[72] Fourth Meeting of the Creditor Committee for Chad under the Common Framework, June 2021. The Fund approved an ECF arrangement for Chad in December 2021: IMF Executive Board Approves New Extended Credit Facility ECF Arrangement for Chad.

assurances in a timely and reliable manner and has yet to deliver on its promise.[73] Both G20/Paris Club members and Fund staff must gain more experience with successful CF debt treatments in order to establish the procedures necessary for the Fund's application of its arrears and financing assurances policies. Staff will monitor the CF's evolution closely and if appropriate will revert to the Executive Board with a stand-alone proposal to amend the LIOA policy.

POLICY ON NON-TOLERATION OF ARREARS TO INTERNATIONAL FINANCIAL INSTITUTIONS

55. The evolution of the international creditor community with new IFI entrants has demonstrated a need for a review of the current approach under the Fund's arrears policies with respect to IFIs . With the exception of the World Bank Group, the designation of the claim holder as "multilateral" under the current approach is based on judgment informed by factors including global membership, and treatment by the Paris Club and under HIPC. Some institutions, such as the long-established Multilateral Development Banks (MDBs) with global membership, are clearly multilateral creditors under the current approach. However, an increasing share of financing to developing countries is extended by IFIs that may or may not have a global membership.[74] While this share remains relatively modest on average, exposures are large in some members with high debt vulnerabilities. In addition, IFIs with regional membership have been proliferating in recent years. The existing criteria do not offer any guidance on how to treat such IFIs, since the HIPC process concluded for most members about ten years ago and the Paris Club has recently only infrequently provided a treatment following the HIPC/Multilateral Debt Relief Initiative (MDRI) Initiatives.

56. A review of the practice over the last ten years suggests that arrears to multilaterals have not generally prevented Fund financing from proceeding but could become a constraint in future OSI cases with substantial IFI exposures. To identify cases of arrears to IFIs, staff reviewed all use of Fund resources cases since 2010.[75] In order to ensure complete coverage, staff cross-checked this information against data received from the World Bank Group on arrears to IFIs (aggregated to preserve the anonymity in the original data). Staff identified 22 staff reports that discussed arrears to IFIs that were either cleared shortly before the issuance of the staff report or that remained outstanding at the time of the approval by the Executive Board. Most cases with arrears to IFIs to date have been in a non-OSI context, and a Credible Plan to clear the arrears was assessed to be in place to enable Fund approval of the financing. More rarely, arrears to IFIs were fully cleared ahead of the Executive Board approval of relevant financing. In all cases where arrears to the World Bank Group could be identified by staff (where the Agreed Plan would have applied),

[73] See: The G20 Common Framework for Debt Treatments must be stepped up, December 2021.

[74] Recent Fund policy papers have documented the growing share of these creditors in lower-income economies' debt stocks. See Macroeconomic Developments and Prospects in Low-Income Developing Countries, March 2018; The Evolution of Public Debt Vulnerabilities in Lower Income Economies, February 2020.

[75] For arrangements, only the staff report for the initial request was reviewed.

the arrears were cleared before the Executive Board approved Fund financing. Staff was not able to find any case where an Agreed Plan was required to clear arrears to IFIs providing substantial financing. In a few recent cases involving new IFIs entrants, staff used its room for judgment to apply the NTP to such entrants. However, this approach is not sustainable in future OSI cases involving substantial exposures to such IFIs, as it would overstretch the existing approach, dilute the NTP, and complicate the restructuring of unsustainable debt.

Recommendations

57. While the policy has worked well overall, it needs to be adapted in light of these developments. Specifically, the proposed reform seeks to meet three objectives.

- **Remove ambiguity.** The policy needs to be clear about the criteria that would be used to decide whether new entrants benefit from the policy or not. The ambiguity of the current policy was less consequential prior to 2015, as the Fund's NTP applied to sovereign arrears on all external claims except those held by private creditors (see Annex III). However, with the establishment of the LIOA policy, the NTP now effectively covers only multilateral claims and Direct Bilateral Claims in respect of which payment in full is contemplated under the program (i.e., non-OSI-related Direct Bilateral Claims). Thus, it is much more important now than prior to 2015 that institutions considered "multilateral creditors" and the treatment of their claims be characterized unambiguously.

- **Avoid dilution.** The approach should ensure that the special treatment of claims held by multilateral creditors not be diluted. The value of that special treatment is reduced as the number of IFIs receiving that treatment increases. The current approach, and its ambiguities, will be difficult to sustain going forward as the number of IFIs increases.

- **Minimize the risk of unintended effects on IFIs.** The proposed amendments only address the treatment of claims under the Fund's arrears policies and should not have implications for the de-facto preferred creditor status (PCS) that certain IFIs may enjoy. However, there is still a risk that a change in the NTP may affect perceptions of the latter, with serious implications for the institutions that are currently covered (or perceived to be covered) by the NTP.

58. To reconcile these objectives, staff proposes to restrict the NTP in OSI cases to two classes of IFIs:[76]

(1) A small set defined by clearly specified mandate and functional characteristics that are closely linked to the Fund's mandate. Specifically, it is proposed that this set encompass: (1) Regional Financing Arrangements (RFAs) and reserve currency union central banks

[76] In a given case, the determination of whether OSI is required would apply to claims held by both official bilateral creditors and IFI claims. The Fund would not micromanage from which creditors the debtor seeks contributions. "Contribution" here comprises, and is limited to, debt relief and new financing (e.g., loans, bond financing, guarantees, and grants).

(RCUCBs), whose operations have the effect of strengthening the GFSN; (2) MDBs with global membership, meaning that their membership includes more than 50 percent of the number of Fund members or more than 50 percent of the Fund's total voting power.

(2) For IFIs outside this set, the Fund would defer to the consensus of the official bilateral creditor community on whether to apply the NTP in a specific OSI case (see ¶61 for details). This achieves two aims. First, it makes it impossible for Fund's arrears policies to have an unintended effect on the perceived PCS of specific institutions, as the treatment of IFIs under the Fund's policies would exactly track the prevailing consensus among the official creditor community on which IFIs enjoy *de facto* PCS. Second, it guards against dilution, as official bilateral creditors have a strong interest to avoid a proliferation of preferred claims.

For any IFIs meeting criterion (1) or (2), a Credible Plan would be required to clear any arrears (except for the World Bank Group, for which an Agreed Plan would always be required; see below).[77] Furthermore, in non-OSI cases, a Credible Plan to clear arrears to all IFIs with two or more sovereign members (and no non-sovereign members) will still be required under the NTP.[78]

Treatment of IFI Claims Under the Proposed New Framework

Agreed Plan: required for arrears to the World Bank Group.

Credible Plan: required for arrears to IFIs if the claim is either non-OSI related, or (even if it is OSI-related) if it is related to (i) RFAs and RCUCBs, and MDBs with global membership or (ii) IFIs identified as being outside the scope of debt restructuring by a creditor committee based on a representative standing forum of official bilateral creditors.

LIOA: applies only in OSI cases, to arrears on IFI claims not covered by the NTP.

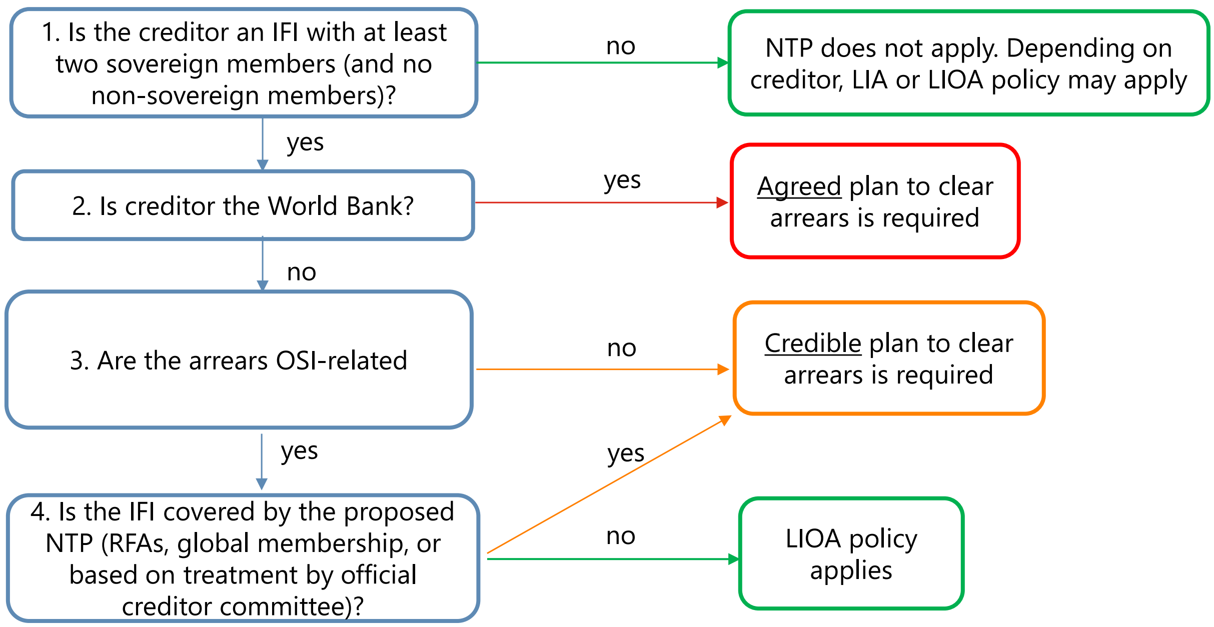
59. In addition, staff proposes to simplify the application of the NTP by no longer requiring an "Agreed Plan" (rather than merely a "Credible Plan") in cases where the IFI provides substantial financing to the Fund-supported program. As discussed above, staff have found no recent case in which this requirement was actually applied. This likely reflects the fact that IFIs can only provide financing to a member in arrears to them (under their overdue financial obligations policies) under very narrow circumstances, usually through grants.

60. Figure 3 summarizes the main features of the proposed multilateral NTP. As is clear from comparing Figure 1 and Figure 3, the key differences between the current and the proposed approach consist of (1) the application of the LIOA policy in OSI cases for IFIs no longer covered by the NTP, and (2) a more precise determination of what institutions are covered under the NTP. For IFIs covered by the NTP, the only change results from the streamlining mentioned above.

[77] A Credible Plan must anticipate the clearance of all arrears within the period of the Fund-supported program, but unlike an Agreed Plan does not require the concurrence of the creditor.

[78] Furthermore, as is currently the case (paragraph 16), the NTP would not apply to claims that are unrelated to the extension of financing by the IFI to the member (such as membership fees or treasury/investment operations).

Figure 3. Decision Tree Summarizing the Proposed Multilateral Arrears Framework



Proposed Amendment 1: Coverage of IFIs Under the NTP in OSI Cases

61. Certain IFIs would receive special treatment even in OSI cases. IFIs that meet any of the following criteria would be covered by the NTP even in OSI cases:

- **RFAs** that form part of the GFSN and (much like the Fund) are set up to assist their members in resolving a BOP problem[79] and RCUCBs, whose operations have the effect of strengthening regional financial safety nets and the GFSN.
- **IFIs with global membership.** The current criteria used to identify multilateral creditors has led to the general protection of claims of the global MDBs. Such MDBs, like the Fund, attempt to pursue the global common interest, albeit through different financial activities. In most cases, they are also likely to be sources of BOP financing complementing Fund support. The NTP should hence continue to protect the claims of these MDBs, without discriminating against new global MDBs, and without allowing the value of that protection to be diluted. This can be achieved by defining global MDBs as IFIs with more than half of the number of Fund members, or a membership in excess of half of the Fund's total voting

[79] More precisely, the Fund defines RFAs as "a finance mechanism backed by pooled resources through which a group of countries pledge common financial support to a fellow member in the event of external liquidity needs for balance of payment (BoP) difficulties." See Collaboration Between Regional Financing Arrangements and the IMF, July 2017, at p. 6. While the list of RFAs is open to new entrants it would currently include: the Arab Monetary Fund, BRICS Contingent Reserve Arrangement, Chiang Mai Initiative Multilateralisation, Eurasian Fund for Stabilization and Development, EU-BOP Facility, ESM, European Financial Stability Mechanism, and the Latin American Reserve Fund.

pool. Apart from the World Bank Group, this criterion is currently met by seven IFIs (Table 3).

Table 3. Twenty-Five International Financial Institutions with the Broadest Memberships

Institution	Type	Members' share of Fund votes	Member Countries
International Monetary Fund		100.0	190
World Bank Group	MDB	100.0	189
Int. Fund for Agricultural Development	MDB	95.4	177
Bank for International Settlements	Other	86.4	61
European Bank for Reconstruction and Development	MDB	77.8	69
African Development Bank	MDB	76.3	82
Asian Development Bank	MDB	72.2	68
Inter-American Development Bank	MDB	68.5	48
Asian Infrastructure Investment Bank	MDB	62.7	83
Council of Europe Development Bank	MDB	28.4	41
Caribbean Development Bank	MDB	26.7	28
European Investment Bank	MDB	25.6	27
European Financial Stability Mechanism	RFA	25.6	27
Eurosystem	RCUCB	21.5	19
European Stability Mechanism	RFA	21.5	19
West African Development Bank	MDB	20.2	14
Chiang Mai Initiative Multilateralization	RFA	18.2	13
New Development Bank	MDB	14.2	5
BRICS Contingent Reserve Arrangement	RFA	14.2	5
Islamic Development Bank	MDB	12.4	57
CAF - Development Bank of Latin America	MDB	10.0	19
OPEC Fund for International Development	MDB	7.4	12
Arab Monetary Fund	RFA	6.0	22
Arab Bank for Economic Development in Africa	MDB	5.7	18
Black Sea Trade and Development Bank	MDB	5.4	11

Sources: IFIs' websites and Fund staff calculations.

- **IFIs identified as being outside the scope of debt restructuring by a creditor committee based on a representative standing forum of official bilateral creditors, as recognized under the LIOA policy.** This would preserve an important element of the current policy—the link to Paris Club treatments, as the Paris Club is currently the only representative standing bilateral official creditor forum recognized by the Fund.[80] But unlike the current policy, it would be based on the treatment of IFIs in the specific case at hand. If , and only if that treatment cannot be decided in the case at hand (or if the creditor committee does not include a member of a representative standing forum), staff would continue to be guided by the IFI's treatment in past cases (past Paris Club or CF treatments with a Paris Club creditor participating). In the absence of such precedent, the Fund would determine whether to apply the NTP or the LIOA policy based on the anticipated treatment

[80] See Box 2: The LIOA policy relevantly provides: "If an agreement is reached through the Paris Club that is adequately representative, the Fund would rely on its current practices […]. Should another representative standing forum emerge, the Fund would be open to engaging with such a forum."

of such IFI by a standing representative forum. As the official creditor committee is likely to reach a view on the treatment of an IFI even if there is no precedent based in past Paris Club and HIPC treatments, and that treatment is likely to be consistent across restructurings, ambiguity would be reduced compared to the status quo. Furthermore, the proposed policy would encourage a parsimonious and flexible application of the NTP, as the same IFI *could* be included under the NTP in one Fund-supported program but excluded in another Fund-supported program (if official bilateral creditors seek comparable treatment in the latter but not the former). Finally, the proposed policy change should reassure regional IFIs that have in the past been consistently treated as preferred creditors by the Paris Club. Unless an official creditor committee that includes a member of a representative standing forum insists on a different treatment, it would continue to benefit from the Fund's NTP.

Proposed Amendment 2. Application of the LIOA Policy to OSI-Related Arrears on Claims Held by IFIs Not Covered by the NTP

62. Staff proposes that the LIOA policy be expanded to apply to OSI-related arrears of IFIs not covered under the NTP. The LIOA policy would be expanded to provide for its application in case of OSI-related arrears on IFIs not covered by the NTP. The modalities for consent would follow the LIOA policy by analogy, whereby consent from the IFI to Fund financing despite the arrears could be conveyed directly to staff or via an Executive Director designated by the IFI. The three criteria under the LIOA policy would also apply, with appropriate adaptations. To the extent that the IFI provides substantial financing (such as grants) to the Fund-supported program, such financing would be taken into account for purposes of the IFI's contribution to the OSI much like for official bilateral creditors.[81] However, an IFI contribution to OSI would not count for purposes of calculating the representativeness of a collective creditor agreement of a standing forum.

63. In addition, for those OSI-related arrears to IFIs, staff proposes to mirror the flexibility in extraordinary circumstances for emergency financing cases in line with the LIOA policy. While the review indicated that the need for flexibility has so far been limited, staff continues to see circumstances in which this could become relevant. In particular, it would appear sensible to reserve such flexibility for emergency situations, such as in the aftermath of a natural disaster, where the extraordinary demands on the affected government are such that there is insufficient time for the debtor to undertake efforts to engage in good faith under the LIOA policy.

Proposed Simplification: Streamlining the NTP

64. In practice, staff has found no case of using the "Agreed Plan" for clearance of arrears to IFIs providing substantial financing to the Fund-supported program. Staff also understands that the provision of new and existing financing to members in arrears to the IFI is substantially

[81] The contribution a debtor seeks from IFIs could differ from the one the debtor seeks from official bilateral creditors and would normally compare among IFIs subject to the LIOA, provided that the overall OSI contribution is consistent with program parameters.

constrained by the IFI's own overdue financial obligations policies and is typically limited to grants, until arrears are cleared in full. Thus, staff proposes than an Agreed Plan will only be required for the clearance of arrears to the World Bank Group.

TREATMENT OF CERTAIN CLAIMS UNDER THE FUND'S ARREARS POLICIES

65. Recent developments have raised some questions about the adequacy of the Fund's approach for dealing with new instruments of official sector financing (such as bonds). These new instruments underline the difficulty of delineating commercial from public-policy activities of different types of public sector creditors.

- The 2015 case of the Russian-held Ukraine Eurobond issued to its National Wealth Fund prompted discussions about whether such bonded debt should be excluded from the Fund's definition of Direct Bilateral Claims. The Executive Board confirmed that such bonded claim was official in December 2015.[82] The episode, however, brought into focus the issue that, had the facts been slightly different (e.g., the bond had more than one holder), official bondholders could have been in a "common voting pool" with private bondholders due to the existence of CACs. This could have potentially complicated both PSI and OSI, given the protections/seniority enjoyed by official creditors under the Fund's arrears policies. Therefore, the systemic implications of including bonds with common voting pools within the Fund's definition of official claims need to be examined.

- Over the last decade or so, the stock of sovereign bonds held for various purposes (such as commercial or monetary policy) by external public-sector entities of official bilateral creditors (such as sovereign wealth funds (SWFs)) has surged. The volume of such claims may now be multiples of the stock of official bilateral loans. Thus far, these claims have generally been presumed not to have been acquired by the official bilateral creditor government or on its behalf and, therefore, as set forth in paragraph 15, have been subject to the LIA policy. However, for consistency across different types of entities and instruments, there is scope for specifying how such judgments are made.

- Some RFAs explicitly recognize secondary market bond purchases as an instrument to maintain or restore orderly bond market conditions in member countries.[83] In the case of the Eurosystem, secondary market purchases of euro-area sovereign bonds are an instrument of monetary policy implementation and transmission and thereby also indirectly contribute to maintain or restore orderly bond market conditions in those Fund member countries. Unlike bond purchases by the above-described official bilateral entities, which typically pursue

[82] Status of Ukraine's Eurobond Held by the Russian Federation, December 2015.

[83] For example, the European Stability Mechanism (ESM) has policies or facilities that envisage such intervention, notably through its Secondary Market Support Facility (SMSF).

commercial objectives, these purchases serve public-policy objectives. As such, they constitute BOP financing-related claims or, in the case of the Eurosystem, claims which are acquired in the context of the euro area's single monetary policy, but also provide *de facto* support to the GFSN and may help resolve the BOP problems of Fund members.

- The classification of certain claims held by state-owned development banks and lending institutions has not been consistent under the Fund's arrears policies. In some cases, those claims have been classified as official (lending on behalf of the government); in others, as private. This inconsistency undermines certainty about the perimeter of Direct Bilateral Claims. One example is the DSSI, in which issues of classification of public development banks arose.

66. Separately, private creditor groups have raised the issue of uncertainty over the perimeter of Direct Bilateral Claims in recent major PSIs. In staff's consultations with private stakeholders, the latter generally recognized the "seniority" of Direct Bilateral Claims that are held for public-policy reasons. However, many felt discomfort with (i) the ambiguity surrounding the perimeter of Direct Bilateral Claims in restructurings (Greece 2012, Ukraine 2015) and recent G20 initiatives (DSSI 2020); and (ii) delays by the debtor in setting the perimeter of the debt restructuring.

Recommendations

67. Staff proposes two amendments and three restatements, as follows:

Proposed Amendment 1. Pooled Voting Mechanism

> **Direct Bilateral Claims** are those claims that are (a) held by a government, or an agency acting on behalf of a government; and (b) originate from an underlying transaction where the creditor government, or an agency acting on behalf of the government, provided or guaranteed financing to the borrowing member.

68. At the time the perimeter of Direct Bilateral Claims was last discussed in 2015, staff considered two polar proposals from Fund members in regard to official claims (i.e., held by official bilateral creditors) held in the form of bonds. At one end, the possibility was raised of treating all bonds held by sovereigns—including those held for commercial purposes—as Direct Bilateral Claims in debt restructurings. The ensuing discussion clarified that this is not a viable option, because it would give unwarranted seniority to a very large stock of otherwise commercially-motivated claims, with adverse implications for markets' pricing of sovereign risk, and governments' ability to undertake a sufficiently deep debt restructurings to solve their debt problems. A related concern is that this approach would imply that bonds held by SWFs could be given Direct Bilateral Claims status, which would seem to run counter to the Santiago Principles.[84]

[84] The Santiago Principles promote transparency, good governance, accountability and prudent investment practices whilst encouraging a more open dialogue and deeper understanding of SWF activities. See Santiago Principles, International Forum of Sovereign Wealth Funds, October 2008.

69. At the other end, some Fund members argued for withholding Direct-Bilateral-Claim status from *all* bonds, including those purchased for public-policy reasons. These shareholders contended that the bondholder could try to seek a treatment in the Paris Club as an official creditor while retaining the option to participate in the PSI ("double dipping"). The tradability and collective payment aspects of bonds were also raised as unique characteristics that could warrant different treatment. While staff did not, and does not, support an instrument-based carve-out, this proposition raises a few issues that deserve further discussion.

70. As a general matter, under the Fund's instrument-neutral approach to defining Direct Bilateral Claims, an exclusion based on the particular form of instrument is inherently arbitrary. The features present in a bond are similarly present in other types of official financing and may also be present in future instruments that may have similar features as bonds but are not called bonds. Specifically:

- **Double dipping—**Bonds are not the only form of debt that has multiple avenues of enforceability. For example, bilateral loans are designed to be legally enforceable. Although debt restructurings, as a matter of practice, are generally done through the Paris Club or bilaterally, official creditors always retain the option of going through the judicial system.
- **Tradability—**Bonds are not the only form of debt that can be traded on the market. For instance, official creditors retain the ability to sell off virtually every bilateral loan.
- **Collective payment mechanism**—While bonds are instruments that have majority restructuring provision for payment terms, they are not the only form of debt that has a collective payment mechanism that would require the same payment to be made to all holders, whether official or private.[85] However, most syndicated loans currently do not have majority restructuring provisions for payment terms.[86]

71. This said, bonded debt instruments do highlight an important concern regarding vote pooling and the uncertainty this can create for both PSI and OSI. Where the official bilateral creditor is part of more than one voting pool (e.g., holds an instrument subject to the same CAC as private bondholders and is also a member of the Paris Club or the Common Framework), this can complicate both restructuring processes. In particular, there would be uncertainty over the perimeter of debt covered in each process, restructuring terms (which depend partly on perimeter), and the prospects of reaching agreement (which would depend on where/how the official creditor votes). Moreover, the official creditor could use its ability to complicate the two processes to try and secure better terms from the debtor. Thus, the pooling of official and private claims could complicate PSIs and be costly for the debtor and the system overall.

[85] For example, syndicated loans have sharing provisions that require equal payment to all holders.

[86] See The International Architecture for Resolving Sovereign Debt Involving Private-Sector Creditors—Recent Developments, Challenges, And Reform Options, October 2020.

72. Staff hence proposes to remove from the definition of Direct Bilateral Claims and IFI/multilateral claims all claims that are contractually part of a pooled voting mechanism with private creditors. While this criterion would apply to any debt instrument, including syndicated loans,[87] its application is immediately apparent with respect to bonds with CACs. This approach would disqualify all bonds with any CACs, including enhanced CACs or traditional CACs from being treated as Direct Bilateral Claims, when a private creditor acquires any bond covered by the enhanced CACs, or a portion of the series in the case of single-series CACs. For example, bonds with single-series CACs could be treated as Direct Bilateral Claims only on the strict condition that the creditor government (or an agency acting on its behalf) maintains continuous and full ownership of the entire bond series. If any part of the series were to be acquired by a private creditor, the entire series would be subject to the LIA policy.[88, 89]

73. To operationalize this criterion, the Fund would rely in the first instance on the creditor's representation of continuous and full ownership. The Fund could challenge that representation but would give the creditor the benefit of any reasonable doubt. To forestall any disagreements with respect to the continuous ownership of the claims, borrowers could be encouraged to include disclosure provisions in the debt contract mandating the trustee to inform the debtor if a transfer of ownership occurs. Another potential (but likely rare) complication could occur if a debtor reopens the issuance and sells such bonds to private creditors. This would cause vote-pooling even absent any action by the official bilateral creditor. To solve this, contractual provisions could be included to prevent the bond series from being re-opened. For existing debt, bonds that are currently held in their entirety by an official bilateral creditor would not lose their official-bilateral-claim status should the debtor choose to re-open the bond issuance and the bilateral creditor continues to hold the entire issuance.

74. There is a risk that this approach could incentivize the issuance of bonds without CACs and undermine the Fund's objectives on wider use of these provisions, but this is likely to be small. In staff's view, official finance to sovereigns (whether in the form of bonds or not) is normally motivated by public-policy objectives. Accordingly, it is unlikely that official bilateral creditors will actually sell their official holdings on the secondary market. Indeed, insofar as the official bonds carry terms that are concessional, a sale of the bonds would result in a loss for the official creditor. The likely loss would be even greater when approaching a restructuring scenario, especially relative to what the official creditor may recoup in a bilateral, Paris Club, or CF process.

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[87] As set forth in paragraph 70, most syndicated loans currently do not have majority voting provisions to amend payment terms. Therefore, the issue of vote pooling is currently much less prevalent for syndicated loans than for bonds with CACs.

[88] Such an amendment would also reflect the Paris Club principle that sovereign creditors are generally expected to maintain control over their official claims (i.e., an unconditional right to take action on these claims, without reference to third parties that could influence the restructuring of these claims).

[89] Bonds without CACs that are held by the private and official sector may not lead to vote pooling problems. Accordingly, the part held by the official sector could be considered a Direct Bilateral Claim.

75. The same rationale described above also applies to instruments held by IFIs that are vote pooled with the private sector. Therefore, staff recommends to also exclude instruments that are vote pooled with the private sector from the special treatment provided to IFI claims.[90]

Proposed Amendment 2. Treatment of Secondary Market Purchases by IFIs

76. In principle, IFI support of Fund members in BOP crises could take the form of bond purchases in the secondary market. In some crisis settings—namely, when debtors have not yet lost access to capital markets, or when private sector borrowing costs are linked to secondary market yields—secondary market bond purchases conducted by IFIs could result in BOP support. Facilities or purchase programs that are set up to undertake such purchases should be considered part of the GFSN. Hence, bonds purchased in the secondary market under such facilities merit special treatment under the Fund's arrears policies, just like direct crisis lending to a sovereign would merit special treatment. This logic generally extends to sovereign bonds acquired under purchase programs of RCUCBs.

77. This said, some IFIs may take the view that certain specific types of secondary market purchases be treated *pari passu* with private claims.[91] One rationale is that large-scale bond purchases by an IFI in the secondary market could have effects in both directions. On the one hand, it raises demand for and prices of bonds purchased, through a variety of channels.[92] On the other, to the extent that the IFI is considered a *de facto* preferred creditor, it may *de-facto* subordinate existing private bondholders, leading to pressure on secondary market prices. Because the latter would contravene the objective of stabilizing bond markets, IFIs may choose to declare that they will not attempt to assert any PCS with respect to bonds purchased in the secondary markets.

78. Staff proposes to clarify that the treatment of such claims under the NTP should take into account the IFI's own stated treatment of the claim. Specifically, if the creditor takes the view that the claim should be treated *pari passu* with privately-held claims, the Fund would defer to the IFI by giving the claim the same treatment under its arrears policies that it would give to a privately-held claim—i.e., the LIA policy would apply. If, however, the IFI does not assert *pari passu* status with respect to bonds purchased in the secondary market, and if its function in conducting such purchases is considered an important component of the GFSN (as explained above), then the Fund would give the claim the special protections described above for IFI claims.[93] Importantly, as explained previously, staff proposes that any vote-pooled claims with the private sector would still be treated under the LIA policy, regardless of the IFI's assertions, for the reasons discussed in paragraphs 67-75.

[90] Arrears on such claims would be treated under the LIA policy.

[91] This is true for the European Central Bank's (ECB) OMT. See Technical features of Outright Monetary Transactions, September 2012.

[92] See Trebesch and Zettelmeyer (2018) for a discussion and evidence on ECB secondary market purchases of Greek bonds.

[93] The Fund would rely on the IFI's assertion at the time of the application of the arrears policy.

Restatement 1. Secondary Market Purchases by Official Bilateral Creditors

79. Secondary market purchases by official bilateral creditors do *not* qualify as Direct Bilateral Claims under the current LIOA policy and staff does not propose any amendments. By its terms, the definition limits Direct Bilateral Claims to those reflecting the *provision* of direct financing to the debtor government. Thus, only primary market purchases by the creditor government or entities acting on its behalf could qualify. Claims acquired in the secondary market by the government or entities acting on its behalf would be subject to the LIA policy (like all residual claims) since they do not provide new direct financing to the debtor. Furthermore, unlike secondary market purchases of bonds by IFIs, there is no sense that these purchases are conducted with the intent of providing BOP support. Rather, their motives tend to be commercial.

Restatement 2. Budgetary Process

80. A few further restatements to the definition of Direct Bilateral Claims appear to be warranted, starting with which entities are "government" creditors. As already highlighted, public-sector entities like SWFs and state-owned banks have emerged as major creditors to other governments.

81. There is currently some ambiguity of whether to treat the claims held by these entities as part of the creditor government's claims and thus eligible for Direct-Bilateral-Claim status with respect to the Fund's arrears policies. Staff proposes to restate that public entities that form part of the member's budgetary process are classified as part of government. The ambit of claims subject to the arrears policies has been kept narrow on the *debtor* side, and staff's restatement would imply a similarly narrow application on the *creditor* side. The definition of what is considered a government claim from the debtor's side is limited to claims of those public sector entities whose financial operations *form part of the member's budgetary process* (Box 6). Staff proposes for operational purposes to focus on a 'budgetary process' test on the creditor side as well. Almost all SWFs and state-owned banks would likely fail this test.

Box 6. Defining the Budgetary Process

For the purposes of the Fund's arrears policies, arrears of a public-sector entity constitute sovereign arrears of the member only when the financial operations of the entity form part of the member's budgetary process. The approach of treating arrears of certain public-sector entities as "sovereign" was first established in 1980.[1] It draws the distinction between "sovereign arrears"—i.e., arrears of the government and of government entities whose financial operations form part of the member's budgetary process—and arrears of "public sector entities independent of the government's day-to-day budgetary controls" that result from government-imposed limitations on the availability of foreign exchange or on payments.

There is no precise definition in the Fund's policy of when "financial operations [of an entity] form part of a member's budgetary process". Rather, it is recognized that the financial arrangements of public entities and the relationship of these entities to the central government may differ between members and need to be examined on a case-by-case basis.[2] Accordingly, the assessment of whether an entity's financial operations form part of the budgetary process of the member is country-specific and based on the domestic budgetary law framework and its interpretation. In particular, ad hoc budgetary support or (occasional)

Box 6. Defining the Budgetary Process (concluded)

coverage of losses may not indicate that the entity forms part of the budgetary process. Similarly, profit transfer from a state-owned enterprise to the central government would also not mean that the entity forms part of the budgetary process. In contrast, an entity that is a direct budgetary unit or that receives direct moneys from the budget would form part of the budgetary process.

[1] Review of Fund Policies and Procedures on Payment Arrears, August 1980, at p. 9.

[2] *Id.*

Restatement 3. Acting on Behalf of the Government

82. Claims held by a creditor entity outside the "budgetary process" could still be considered Direct Bilateral Claims if they were acquired explicitly "on behalf of" the government. The obvious example would include guarantees/indemnifications issued explicitly on behalf of the government by export credit agencies (ECAs) that reside outside the budgetary process.[94] Central bank swaps for BOP support could also qualify as Direct Bilateral Claims to the extent the central bank were to act on behalf of the government. In these cases, while the creditor member's representation—including at the Paris Club—on whether the entity acted on the government's behalf would be important, the member could be asked to provide supporting evidence where Fund staff deem necessary.

83. Staff proposes restating that an assessment of whether an entity is acting "on behalf of the government" needs to take into account the totality of circumstances of a specific case. The creditor's consistent representation on whether the entity acted on the government's behalf would need to be supported by unambiguous documentary evidence. In particular, important elements to consider would be the governance structure of the entity; whether the claim in question originated from explicit directions from the government; and—where relevant—the terms of the financing provided. In this context, claims held or guaranteed/indemnified by ECAs would normally pass this test, given that these institutions benefit from a sovereign mandate and have consistently co-operated in sovereign debt restructurings at the Paris Club. However, a claim-by-claim analysis will always be required.

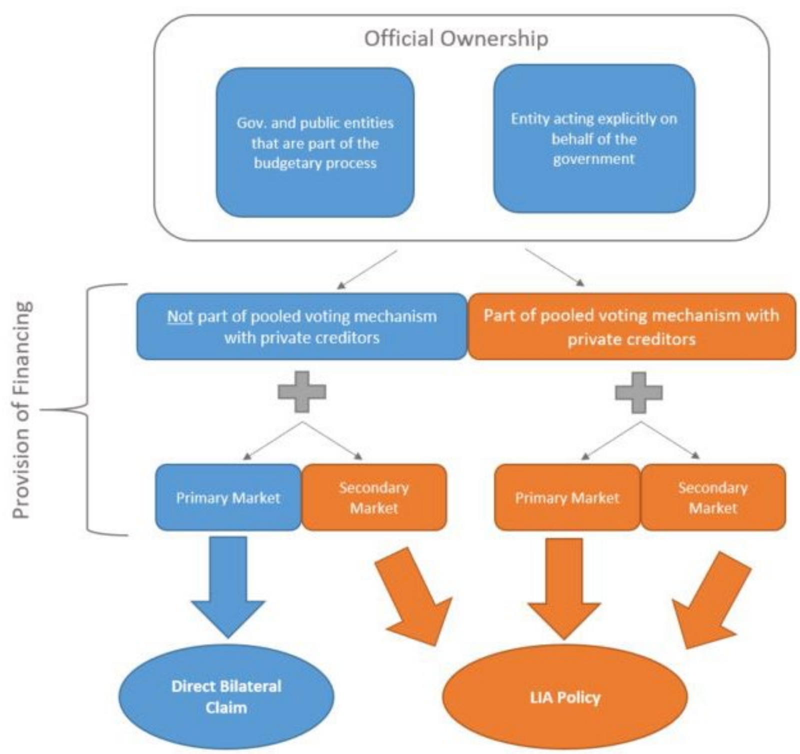
84. The Fund's definition of Direct Bilateral Claims does not need to always align with claims treated in the Paris Club or under other representative creditors fora (such as the CF). While the Fund uses a claim-by-claim analysis to determine the classification of claims for purposes of Fund policies, the Paris Club often uses an institution-by-institution approach to encompass a broader scope of claims in its treatments for efficiency reasons. While it is important to maintain a close alignment between the Fund's definition and the Paris Club practice, exact one-to-one

[94] See also the Russian National Wealth Fund's claim on Ukraine, which was acquired on the explicit direction of the Russian government. Status of Ukraine's Eurobond Held by the Russian Federation, December 2015.

mapping may not be necessary. In fact, treatment has differed on the margins in the past without any material complications.

85. These amendments and restatements would not constitute a major departure from current practice (See Figure 4). Most claims that have typically been treated in the Paris Club (development assistance, BOP support, the bulk of ECA guarantees) would continue to be classified as Direct Bilateral Claims. However, these proposals would clarify the treatment of some types of financing that have so far not been subject to an assessment against the Fund's definition of a Direct Bilateral Claim but that are becoming more important. For example, central bank swaps would be classified as Direct Bilateral Claims to the extent the central bank acts on behalf of the government for BOP purposes; while secondary market purchases of sovereign bonds for portfolio or reserve management purposes by central banks and SWFs would not.

Figure 4. Determination of a Claim as a Direct Bilateral Claim



ISSUES FOR DISCUSSION

86. Staff proposes that all proposed amendments enter into force immediately. If the Baard supports the proposed amendments, they will apply immediately to all future Fund disbursements, including under existing arrangements with respect to existing and future arrears.

87. Staff seeks Directors' views on the following issues:

- Do Directors agree that the LIA policy remains broadly appropriate? Do Directors agree with staff's proposals to update and sharpen the LIA policy's guiding principles on good faith set forth in paragraphs 32-37?
- Do Directors agree with staff's proposal to codify the current practice into a Fund policy with respect to preemptive debt restructurings with enhanced debt transparency expectations described in paragraphs 47-48?
- Do Directors agree that the LIOA policy remains broadly appropriate, and no amendments are necessary?
- Do Directors agree with staff's two proposed amendments and one simplification with respect to the treatment of arrears to IFIs, as described in paragraphs 57-64? Do Directors agree with staff's proposed amendment on the treatment of arrears on secondary market purchases held by IFIs described in paragraphs 76-78?
- Do Directors agree with staff's one proposed amendment and the three restatements with respect to the definition of Direct Bilateral Claims as described in paragraphs 67-75 and 79-85?

Annex I. The Fund's Policies on Debt Sustainability, Market Access, Financing Assurances, and External Arrears

1. **Under Articles I(v) and V, 3(a) of the Articles of Agreement, Fund financing can only be provided under adequate safeguards in support of a member's economic policies that are capable of resolving the member's balance of payments problem over a timeframe consistent with the revolving nature of Fund financing and restore the member to medium-term external viability.** To ensure Fund financing adheres to this standard, the Fund has established inter-related policies on debt sustainability, market access, financing assurances, and lending into arrears. This annex describes these policies, with particular focus on sovereign debt restructuring situations.

A. Debt Sustainability

If debt is unsustainable, the Fund is precluded from providing financing unless the member takes steps to restore debt sustainability.

2. **When a member requests Fund financing, the Fund assesses whether the member's policies are consistent with preserving debt sustainability.**[1] This assessment is based on a debt sustainability analysis (DSA) that is forward looking—i.e., it takes into account steps being taken by the member to restore sustainability over the medium term—and incorporates alternative scenarios and stress tests.[2] The Fund is precluded from providing financing (including emergency assistance—see Box 3 and B) where the member's debt is assessed to be unsustainable, unless the member takes steps to restore debt sustainability.[3]

3. **Fund-supported programs seek to strike an appropriate balance between adjustment and financing.** Financing, including from the Fund, helps to smooth a member's adjustment and making it less costly for both the member concerned and the international community. Fund financing is usually only a fraction of total financing. Other creditors, official or private, are generally expected to contribute to the financing of the program as well.[4]

[1] Debt is considered sustainable when a borrower is expected to be able to continue servicing its debts without an unrealistically large correction to its income and expenditure.

[2] As noted above, Fund financing must be provided in a manner that establishes adequate safeguards on the temporary use of the general resources of the Fund. Accordingly, one of the reasons why judgments regarding debt sustainability need to focus on the medium-term scenario (rather than just the program period) is that a determination must be made that the member has the capacity to repay the Fund, taking into consideration the maturity of all indebtedness, including indebtedness to the Fund.

[3] See, e.g., Lessons from the Crisis in Argentina, February 2005; Sovereign Debt Restructuring–Recent Developments and Implications for the Fund's Legal and Policy Framework, April 2013.

[4] OSI can be in the form of new financing, swaps, and debt relief. Private sector involvement takes various forms. It is typically reflected in assumptions about private sector capital flows (and their composition, e.g., bonds, bank loans and their characteristics) and rollover by creditors, based on the expected impact of the Fund-supported program on private sector sentiment. It can also be made more formal, such as the commitment by banks to maintain exposure.

4. If debt is unsustainable (i.e., the Fund determines that debt sustainability cannot be preserved through credible and sustainable policy adjustment), the Fund is precluded from providing financing unless the member takes steps to restore sustainability.[5] These steps could themselves restore sustainability (e.g., the provision of new concessional financing or the completion of a debt operation) or, where upfront restoration of sustainability is not feasible, could provide the Fund with the requisite assurances that the member is on track to restore sustainability. Two types of assurances are possible under this latter scenario: (1) where grants or highly concessional financing is sought from donors, assurances can be sought directly from the donors as to the amount and timing of the contribution; or (2) where the financing involves rescheduling—a change in contractual terms—the form of assurances depends on the nature of creditors, whether Paris Club or non-Paris Club official creditors, or private creditors (Box AI.1 and Box AI.3). The treatment of Paris Club creditors is a product of the long relationship of the Fund with the Paris Club (Box AI.2).

Box AI.1. Assurances on Debt Sustainability[1]

When assurances with respect to contributions to restore debt sustainability are required from **Paris Club official bilateral creditors**, such assurances are provided by a Club meeting to provide a preliminary indication that the Club is willing to provide debt relief in anticipation of an Agreed Minute. Such a meeting can be arranged on reasonably short notice. If the contributions from Paris Club creditors are representative (i.e., a majority of contributions required from official bilateral creditors over the program period), due to comparability of treatment provisions in Paris Club Agreed Minutes, and due to the Fund's arrears policies (allowing non-participating creditors to be "deemed away" for the purposes of the Fund's arrears policies, and thus giving the authorities leverage), other creditors can be assumed to provide debt relief on the same terms as the Paris Club.

When **non-Paris Club official creditors** constitute the key group, "specific and credible" assurances on financing/debt relief are required from the creditors such that debt sustainability is restored and the Fund-supported program is fully financed. This has been understood to mean a communication from a sufficiently high-ranking official authorized under domestic law to commit the creditor. This communication should preferably be written and must show an understanding of the debtor member's situation and the needed actions to restore debt sustainability in line with program parameters. The actual debt restructuring can come later. This parallels what is asked of Paris Club creditors.

When a contribution from **private creditors** is required to restore debt sustainability, assurances are derived from a staff's judgment that a credible process for debt restructuring is underway and such restructuring will likely deliver an outcome in line with program requirements. Relevant considerations include the engagement of legal and financial advisors by the member, the launching of consultations with creditors, and the design of a debt restructuring strategy, including the terms of the new instruments and use of inducements for creditor participation. When creditors with greater leverage are involved (e.g., foreign law-governed debt, collateralized claims, or blocking positions to neutralize collective action clauses), the process would need to be further along to provide sufficient assurances. The Fund has indeed in some cases decided to approve financing only after completion of a debt exchange.

[1] While assurances are typically not conveyed verbatim to the Executive Board, the Executive Board must be informed of their existence and their substance in order to make an informed decision on Fund financing.

[5] Under the exceptional access policy, a higher degree of probability is required for the Fund to proceed with approval of an arrangement in cases of unsustainable debt: The steps taken by the member must render debt sustainable with high probability. Access Policy and Limits in the Credit Tranches and Under the Extended Fund Facility and on Overall Access to the Fund's General Resources, and Exceptional Access Policy—Review and Modification, Decision No. 14064-(08/18), February 2008, as amended, paragraph 3(b).

Box. AI.2 Evolution of Paris Club's Debt Treatment and Coordination with the Fund

The Paris Club was established in 1956[1], with the original aims of preventing sovereign debt defaults and ensuring full repayment of debt. The Paris Club generally relied on debt reschedulings that were short-term and structured at market rates, which aimed to give countries time to recover and repay their debts.[2] Follow-up reschedulings were often required.

The Fund and the Paris Club adapted their practices over time, notably during the sovereign debt crisis of the 1980s.[3] The oil price shocks of 1973 and 1979 generated huge trade surpluses for the oil-rich, and corresponding deficits for the oil-poor. This in turn led to high inflation, increased global liquidity and rising global indebtedness, leading to multiple sovereign debt crises. The debt crisis necessitated changes to approaches in providing debt relief, and the Fund began to work towards longer-term solutions to the debt crisis. Similarly, the Paris Club had started to provide rescheduling of debt on "exceptional terms," which was required for certain countries with large financing gaps. Exceptional terms generally included rescheduling at below-market rates, with grace periods and maturity periods that were longer than the norm.

Since 1988, the Paris Club can provide debt write-offs to low-income countries and played a key role in the implementation of the HIPC Initiative. While "exceptional" treatment of debt reflected a more concessional approach towards debtor countries, it was still anchored within a rescheduling framework. During a G-7 meeting in Venice in 1987, developed countries began to acknowledge the need for additional debt relief for poorer countries. This led to the development of the "Toronto Terms"[4] in 1988, which allowed debt reduction of up to 33 percent for the poorest countries, with longer repayment periods or lowered interest rates on remaining debt. The development of the "Toronto Terms" spurred the development of further terms for debt reduction, culminating with wide-scale debt relief under the HIPC Initiative. Under the "Cologne Terms" [5], countries eligible for the HPIC Initiative were granted debt cancellation of up to 90%. The Paris Club played a critical role in the implementation of the HIPC Initiative for low-income countries.

In 2003, the Paris Club adopted a new protocol – the "Evian Approach" – in considering debt relief for non-HIPC countries. The "Evian Approach"[6] does not provide standardized terms of treatment, but a case-by-case approach, incorporating debt sustainability considerations and the financial needs of the debtor. For countries facing a liquidity issue, reschedulings could be considered. For countries facing a solvency issue, comprehensive debt treatment—which could include principal or NPV reduction, in addition to reschedulings—could be granted at different stages, tied to a debtor country's compliance with multiple Fund-supported programs.

The evolution of the Paris Club's approach to debt treatments, from providing only reschedulings to offering debt reduction to both HIPC and non-HIPC countries, dovetails with Fund's focus on debt sustainability. The Fund expressly recognized debt sustainability as a key safeguard in 2002.[7] Even prior to 2002, the Fund's focus was on restoring the member to medium term external viability – a concept linked to debt sustainability– as articulated through the financing assurances policy. [8] Given the adoption of the "Evian Approach" and "Cologne Terms" in the Paris Club, debt sustainability, in combination with Fund-supported programs, will be a key factor driving the analysis in providing debt relief.

Box. AI.2 Evolution of Paris Club's Debt Treatment and Coordination with the Fund (concluded)

[1] The website of the Paris Club also provides an overview of its history and development: https://clubdeparis.org/en/communications/page/historical-development.

[2] See Cheng, Diaz-Cassou, and Erce (2018); Cosio-Pascal (2008).

[3] For a fuller description of the sovereign debt crisis of the 1980s, see IMF, Prevention and Resolution of Sovereign Debt Crises, Selected Legal and Institutional Papers Series, 2018.

[4] See https://clubdeparis.org/en/communications/page/toronto-terms.

[5] See https://clubdeparis.org/en/communications/page/cologne-terms.

[6] See https://clubdeparis.org/en/communications/page/evian-approach.

[7] This was first articulated when the Exceptional Access Policy was developed 2002, whereby one of the criteria for exceptional access is that there is a high probability that debt will remain sustainable, based on rigorous and systemic analysis. Access Policy in Capital Account Crises, July 2002.

[8] While the concept of debt sustainability was not used then, the Fund recognized that there were members which had unsustainable debt. See page 7 of The Fund's Policy on Financing Assurances, April 1989: "It is now clear that, for certain members, the restoration of balance of payments viability will require some debt or debt-service reduction in the medium-term. In these cases, the provision of new money on commercial terms to the exclusion of debt reduction would not be consistent with a return to viability or the repayment of the Fund."

Box AI.3. Debt Sustainability in Emergency Financing Cases

Requests for emergency lending (RFIs or RCFs) in an unsustainable debt situation can be particularly difficult for the Fund, as it often entails a natural or health disaster layered on top of a debt crisis. While Fund assistance is needed urgently, upfront financing without safeguards can make the situation worse if the money is used to pay off existing creditors, doing nothing to help with the disaster, and making the resolution of the debt situation more difficult.

The debt sustainability requirement could be met in some cases if the Fund has adequate assurances that the member is on track to restore sustainability, e.g., through a debt restructuring.[1] Assurances from creditors about actions to restore debt sustainability remain critical, and the standards for such assurances (Box AI.1) continue to apply. A case-by-case assessment would be needed.

In very rare cases (Iraq 2004 and Lebanon 2006), the Fund found that the requirement for adequate assurances (that the member is on track to restore sustainability) was met through assurances from official bilateral creditors to restore debt sustainability against the backdrop of concerted international action. Specifically, management consulted through the relevant Executive Directors with the majority of the relevant member's official bilateral creditors. In those cases, the creditors (i) recognized the Fund's preferred creditor status in respect of the relevant member's purchase under the emergency assistance, (ii) were willing to make their best efforts—given the relevant member's continuing cooperation with the Fund—to provide debt relief on appropriate terms to ensure timely repayment to the Fund of the amounts provided under the emergency assistance, in accordance with the Fund's preferred creditor status; and (iii) confirmed that, during the period of the emergency assistance, a deferral would be in place with respect to those obligations of the relevant member that are falling due to them.

[1] Sovereign Debt Restructuring–Recent Developments and Implications for the Fund's Legal and Policy Framework, April 2013.

B. Market Access

5. Closely related to—but distinct from—the concept of debt sustainability is that of market access. While lack of debt sustainability normally triggers loss of market access, temporary loss of market access does not necessarily imply that debt is unsustainable. To address its underlying problems and achieve medium-term external viability, a member needs to restore investor confidence and re-establish its capacity to regain access to international private capital.

6. The Fund's exceptional access policy, *inter alia*, requires that the member has prospects of (re)gaining access to international private capital markets within the timeframe Fund resources are outstanding. In practice, whether a country is assessed to have (or be able to regain) market access will depend on its ability (current or prospective) to tap international capital markets on a sustained basis through the contracting of loans and/or issuance of securities across a range of maturities, regardless of the currency denomination of the instruments, and at reasonable interest rates.

C. Financing Assurances Policy

7. The Fund's financing assurances policy aims at ensuring consistency of Fund financing with the member's return to medium-term external viability to give the Fund assurances that it can be repaid by the member within the medium term. The financing assurances policy was developed during the 1980s debt crisis, when commercial banks were trying to limit their exposure to heavily indebted countries, and the Fund could no longer assume that these banks would be willing to assist spontaneously in the financing of Fund-supported programs for these countries. The policy initially required that, as prior condition to the availability of Fund assistance, other creditors (official and private) needed to furnish specific assurances that they would provide the necessary support (either through new loans or refinancing) to fill the estimated gaps in the financing of the program on terms consistent with the member's return to external viability.[6] In the late 1980s, the Fund recognized that strict adherence to the receipt of explicit financing assurances effectively gave commercial banks a veto over Fund financing, thereby undermining the Fund's ability to provide timely assistance to members that were making efforts to address their balance of payments problems. To realign the policy with its underlying objectives, the Fund modified the financing assurances policy to allow the approval of an arrangement before banks had provided assurances as to their willingness to support a financing package consistent with the assumptions of the program.[7]

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[6] In practice, the Fund required a formal confirmation from a critical mass of banks through their advisory committees. A critical mass was considered to be the level of participation that made the implementation of financing agreement virtually certain. The share of banks that constituted a critical mass was a matter of judgment on a case-by-case basis, but generally over 90 percent.

[7] To address concerns about the adequacy of safeguards, the modified policy provides that such approval can be granted only in cases where (i) prompt Fund support is judged to be essential for program implementation, (ii) negotiations between the member and its creditors have begun, and (iii) it can be expected that a financing package consistent with external viability will be agreed within a reasonable period of time. Progress in the negotiations with bank creditors would be closely monitored. See Summing Up by the Chairman on Fund Involvement in the Debt

(continued)

8. Under the financing assurances policy, the Fund needs to be satisfied that program financing is adequate to fill financing gaps: (i) during the program period to ensure viability as well as (ii) to ensure that the member is in a position to repay the Fund during the post-program period.[8]

- In practice, the condition that the program be "fully financed" requires the following judgments to be made: (i) "firm commitments" of financing must be in place for the first 12 months of the arrangement, and (ii) there must be "good prospects" that there will be adequate financing for the remaining program period beyond the first 12 months. During program reviews, assurances on full financing of successive 12-month periods beyond the initial 12 months (or whatever period is left under the arrangement) must be ascertained. Specifically, the "good prospects" must become "firm commitments" or actual financing.[9]

- With respect to the post-program period, staff needs to assess whether the member's prospective policies deliver a projected post-program performance that adequately safeguard repayments to the Fund consistent with a sustainable debt path during the program period. Good prospects of regaining market access and debt sustainability are germane to the observance of the financing assurances policy. A Fund-supported program in the Fund's General Resources Account (GRA) is designed to restore the member to medium term external viability and resolve the BOP problem within the program period.[10, 11, 12]

9. In programs involving debt restructuring, the financing assurances policy does not prescribe the allocation of financing (through new financing and/or debt restructuring) to be provided between official and private creditors. In case the financing gap cannot be filled with

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Strategy, May 1989. This modification also necessitated a revision of the arrears policy by introducing the LIA policy to allow for the accumulation of arrears to external private creditors (see Annex III).

[8] The financing assurances policy applies to all Fund-supported programs, including those supported by Policy Coordination Instruments (PCI) and Policy Support Instruments (PSI). For stand-alone emergency financing (i.e., under the Rapid Credit Facility and Rapid Financing Instrument), the requirements under (i) are set aside given that there is no underlying economic program. The financing assurances policy does not apply to support under the Flexible Credit Line and the Short-term Liquidity Line.

[9] There is no defined meaning of the term "firm commitments". In practice, the manner in which such commitments are provided varies, and whether they are characterized as "firm" is a matter of judgement. Also, while such commitments do not have to be in writing, they must be considered credible by management; creditors providing such assurances should be willing to have their commitments reflected in program documents, which will be eventually published.

[10] 2018 Review of Program Design and Conditionality, May 2019.

[11] Under ECF arrangements under the PRGT, the protracted BOP need does not need to be resolved within the program period. However, any financing gaps in the post program period for an ECF arrangement need to be such that, notwithstanding the gaps, the Fund is assured that the member has the capacity to repay the Fund (irrespective of a successor arrangement), and that any gaps are consistent with a sustainable debt path.

[12] Staff would need to assess that the member has good prospects for (re)gaining access to capital markets at sufficient depth, maturity, and price to ensure capacity to repay the Fund and consistent with a sustainable debt path, taking into account all sovereign maturities falling due in the post-program period during the time repayments to the Fund are outstanding. As along as obligations to the Fund are outstanding, staff needs to judge that there no financing gaps in the post-program period at arrangement approval and each respective program review.

new financing (from the official and/or private sector), the Fund's policy on financing assurances encourages the restructuring of creditors' claims on the country on terms compatible with balance of payments viability.[13] Assurances about debt sustainability and financing in these cases are obtained as laid out above under the section on debt sustainability (Box AI.1).

10. The Fund always encourages members to stay current on their obligations to the extent possible. Sometimes, however, financing gaps are filled through the accumulation of arrears. In these instances, the arrears policies, discussed in the next section, set forth a framework under which the Fund can provide financial assistance to members despite such arrears. The ultimate goal of the Fund's arrears policies is to ensure that the member will soon regularize its relations with creditors, thereby resolving the arrears and ensuring its medium-term viability and securing the financing assurance required for the post-program period.

D. Arrears Policies

11. Recognizing the destructive nature of arrears, since 1970, the Fund has had a policy of non-toleration of arrears (NTP), unless a specific policy applies that enables the Fund to lend into sovereign arrears. These specific policies are those on Lending into sovereign Arrears (LIA) to private creditors—which was adopted in 1989 and last reviewed in 2002—and on Lending into Arrears to Official Bilateral Creditors (LIOA), which was adopted in 2015. The application of the specific arrears policies depends on (i) whether a sovereign debtor member ("member" or "debtor") is in arrears to private sector, official bilateral, or multilateral creditors, and (ii) whether Private Sector Involvement (PSI) and/or Official Sector Involvement (OSI) is needed.[14] The arrears policies do not apply to claims in dispute (Box AI.4, below).

Box AI.4. Disputed Claims Doctrine

The Fund's arrears policies do not apply to arrears on claims in dispute. Under this practice, where the Fund accepts a member's representation that the validity or amount of a debt claim is in dispute, such disputed claim does not give rise to arrears for all Fund purposes.[1, 2] However, such claims are taken into account (as a contingent claim) for purposes of determining whether adequate assurances exist for the financing of a Fund-supported program and the DSA. The disputed claims doctrine is grounded in the Fund's duty of neutrality. As an international organization, the Fund must maintain a neutral position with respect to claims whose underlying validity or amounts are in dispute between members.[3]

[13] Sovereign Debt Restructuring–Recent Developments and Implications for the Fund's Legal and Policy Framework, April 2013.

[14] Where a claim is OSI-related and ultimately restructured through a legally binding agreement between the parties, the new (restructured) claim normally replaces the old claim through novation. Thus, if arrears arise anew under the restructured claim, such claim would not be considered OSI-related unless a new such determination is made by the Fund.

Box AI.4. Disputed Claims Doctrine (concluded)

Although the Fund reserves the right to challenge a member's representation of a dispute, it has given the member the benefit of any reasonable doubt in this regard. In line with this practice, staff has on rare occasion queried whether there was a factual basis for a member to credibly represent a dispute to the Fund. The considerations relevant to staff's queries have included the record of the positions between the debtor and creditor, the record of statements to the Fund, the arguments made in any litigation, and the status of such litigation. The Executive Board makes the final determination of claims in dispute.

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[1] See The Role of the Fund in the Settlement of Disputes Between Members Relating to External Financial Obligations, May 1984, p. 8.

[2] Where only a portion of a claim is in dispute—e.g., the amount recognized by the debtor is less than the amount claimed by the creditor—only the difference in the amount would fall under the disputed claims doctrine; the portion of the claim recognized by both parties would be treated as an undisputed claim.

[3] The Role of the Fund in the Settlement of Disputes Between Members Relating to External Financial Obligations, May 1984 and the related Summing Up, June 1984; Recent Developments in Sovereign Debt Litigation and Implications for Debt Restructuring and Debt Relief Processes, March 2004.

12. **For both the LIA and LIOA policy, as long as there are external arrears to creditors (either private or official bilateral), the Fund needs to conduct a financing assurances review at the approval of an arrangement or emergency financing or at each program review.**[15] Financing assurances reviews—which are distinct from the above-described financing assurances policy—provide the Fund with the opportunity to assess progress in restoring debt sustainability in a context where the member has incurred external arrears as well as to determine whether there are sufficient safeguards in place for the further provision of Fund financing in the member's circumstances. In particular, the Fund needs to determine whether the member's adjustment efforts are undermined by developments in debtor and creditor relationships, and whether in light of progress the existence of arrears is temporary and, therefore, does not undermine the medium-term external viability of the member's balance of payments and its capacity to repay the Fund.[16] The recommendation to complete the financing assurances review requires staff's judgment that, in light of progress made in restructuring the member's debt, the Fund should continue to provide the member with access to Fund resources.

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[15] The arrears policies apply to all Fund financing instruments. They also apply to the Policy Support Instruments and Policy Coordination Instruments by analogy. They do not apply to SMPs. As described in the main paper, the arrears policies apply with some flexibility to financing under the RCF and RFI.

[16] See Summing Up by the Acting Chairman—Fund Policy on Arrears to Private Creditors—Further Considerations, June 1999; and Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors, December 2015.

13. The arrears policies interact in important ways with the financing assurances and debt sustainability policies:[17]

- *Financing assurances.* As noted above, financing gaps may be filled through the accumulation of arrears so long as the relevant arrears policy is satisfied.

- *Debt sustainability.* Application of the arrears policies, which are underpinned by criteria designed to restore debt sustainability, may provide sufficient safeguards to negate the need for further assurances on debt sustainability. In particular, the application of the LIA or LIOA criteria, including the provision of consent by the creditor Executive Director, will generally act as a safeguard to assure the Fund that a restructuring deal will be forthcoming that will restore debt sustainability.[18, 19] To the extent the member makes a debt restructuring offer to creditors, such offer must be consistent with program parameters. As an additional safeguard, the financing assurances reviews required under the LIA/LIOA policies allow the Fund an opportunity at each program review to reassess the status of debtor-creditor negotiations and whether a restructuring deal is likely to be forthcoming. Thus, staff could also assess that no assurances regarding the restoration of debt sustainability beyond the application of the arrears policies are required, depending on the member's circumstances.

- However, in cases where there are significant uncertainties that the creditor(s) will restructure their claims (e.g., the debt is collateralized and/or there is a high legal risk that creditor action could severely undermine program implementation) and such restructuring is critical to achieving debt sustainability and medium-term viability, the Fund may still need to seek further assurances from the creditor(s) as laid out in Box AI.1 before approval of an arrangement or completion of a review to sufficiently establish safeguards for Fund resources.

[17] Where the member has defaulted on some, but not all, of its external claims, the standard for assurances laid out in the above section on debt sustainability would need to be met for all claims; the arrears policies could only be used to satisfy that standard for claims in default.

[18] This includes cases where, under the exceptional access policy, debt sustainability must be restored with a high probability. If the member's offer had not yet been made, the Fund could proceed if an offer consistent with debt sustainability was expected to be forthcoming.

[19] This was explicitly recognized in The Fund's Policy on Financing Assurances, April 1989, which stated that: "The member would … need to maintain a negotiating position toward its commercial bank creditors that was broadly consistent with the assumptions of the adjustment and financing program being supported by the international community."

Annex II. Creditor Dialogue in Pre- and Post- Default Debt Restructuring

Table AII.1. Creditor Dialogue in Pre- and Post- Default Debt Restructurings

	Time between announcement of restructuring and start of dialogue	Did the debtor share non-confidential relevant information with creditors? 1/	Did the debtor provide creditors with early opportunity to give input on the design of the restructuring?	Type of creditor dialogue: Creditor Committee (CC), London Club (LC); Bilaterally (Bil.)	If creditor committee formed, share of claims represented	Debt treated (US$bn)	NPV Haircut Estimate 2/	Participation rate 3/	Time from announcement to completion of restructuring
Pre-default restructurings									
Belize 2007 (Ext Bonds/Loans)	2m	Yes	Yes	CC	>51%	0.5	23.7%	98.0%	7m
Belize 2013 (Ext Bonds)	2m	Yes	Yes	CC	37%	0.5	31.5%	100.0%	6m
Belize 2017 (Ext Bonds)	2m	Yes	Yes, (after initial consent solicitation)	CC	60%	0.5	19.7%	100.0%	4m
Chad 2015 (Ext Loans)	<7m	No info.	Yes	Bil.	n/a	1.5	n/a	100.0%	15m
Chad 2018 (Ext Loans)	<5m	Yes	Yes	Bil.	n/a	1.2	27.3%	100.0%	17 m
Cyprus 2013 (Dom/Ext Bonds)	<1 m	No info.	No info.	Bil.	n/a	1.2	35.8%	100.0%	1 m
Dominican Republic 2005 (Ext Bonds)	9 m	Yes	Yes	Bil.	n/a	1.1	4.7%	97.0%	14 m
Ecuador 2020 (Ext Bonds)	2m	Yes	Yes	CC (3 committes)	53%	17.4	42.4%	100.0%	5m
Greece 2012 (Dom/Ext Bonds)	<1 m	No info.	No info.	CC	30-40%	273.4	64.6%	96.9%	9 m
Grenada 2005 (Dom/ExtBonds/Loans)	2 m	No info.	Yes	CC	>70%	0.3	33.9%	93.3%	14 m
Jamaica 2010 (Dom Bonds)	<1m	Yes	No info.	Bil.	n/a	7.9	22.5%	99.2%	1 m
Jamaica 2013 (Dom Bonds)	<1 m	Yes	No info.	Bil.	n/a	9.1	24.2%	99.0%	1 m
Molodva 2002 (Ext Bonds)	<1 m	No info.	Yes	Bil.	n/a	0.0	36.9%	100.0%	5m
Mongolia 2017 (Ext Bonds)	<1 m	Yes	No (but reprofiling only)	Informal; Bil.	n/a	0.6	-3.0%	90% 4/	<1 m
Mozambique 2016 (Ext bond)	<1 m	No	No (but reprofiling only)	CC	n/a	0.7	-5.7%	85.0%	10 m
Nicaragua 2003 (Dom bonds)	<1 m	No info.	No info.	Bil.	n/a	0.3	n/a	100.0%	1 m
Nicaragua 2008 (Dom bonds)	< 2 m	No info.	No info.	Bil.	n/a	0.3	95.5%	100.0%	2 m
Ukraine 2015 (Bonds/Loans)	2 m	Yes	Yes	CC; Bil. for SOE debt	44%	18.0	23.2%	100.0%	10m
Uruguay 2003 (Ext Bonds)	<1 m	Yes	Yes	Bil., Roadshows (2)	n/a	5.4	9.8%	91.5%	3 m
Average/Share	2m	Mostly yes	Mostly yes	8/19 had CC	48%	1.1	24.2%	100%	5 m
Post-default restructurings (LIA cases)									
Argentina 2005 (Dom/Ext Bonds)	<1m	Yes	No	CC	>50%	79.7	76.8%	80.3%	42m
Argentina 2020 (Dom/Ext Bonds)	4 m	Yes	Yes	CC (3 committes)	40-45%	65.5	35.6%	99.0%	9m
Barbados 2019 (Dom/Ext Bonds/Loans)	<1m	Yes	Yes	CC	>50%	0.8	24.3%	100.0%	19m
Côte d'Ivoire 2010 (Ext. Bonds)	<1 m	Yes	No info	LC	100%	0.1	6.1%	100.0%	21m
Congo, Rep. ongoing (Ext Bonds/Loans)	>6m	Yes	Yes	Bil.	n/a	n/a	n/a	n/a	ongoing
Dominica 2006 (Bonds/Loans)	7 m	Yes	Yes	Bil., Roadshow	n/a	0.1	54.0%	72%	36 m
Dominican Republic 2005 (Ext Loans)	4 m	No info	No info	LC	n/a	0.2	11.3%	N/A	18 m

Table AII.1. Creditor Dialogue in Pre- and Post- Default Debt Restructurings (concluded)

Grenada 2015 (Bonds/Loans)	12 m	Yes	Yes	CC	>50%	0.2	50.3%	100.0%	32 m
Iraq 2006 (Bank/Comm. Loans)	> 7 m	No info	No info	CC, Bil.	n/a	17.7	89.4%	96.0%	20 m
Mozambique 2019 (Ext bond)	17m	Yes	Yes	CC	68%	0.7	11.0%	99.5%	35 m
Serbia-Montenegro 2005 (Loans)	10 m	No info	No info	LC, Bil.	n/a	2.7	70.9%	n/a	44 m
Seychelles 2010 (Ext Bonds/Loans)	< 1 m	Yes	No info	Bil., Roadshow	n/a	0.3	56.2%	100.0%	19 m
St. Kitts & Nevis 2012 (Bonds/Loans)	3 m	Yes	Yes	CC and Bil./Roadshow	n/a	0.1	62.9%	100.0%	10 m
Suriname ongoing (Ext Bonds/Loans)	<1m	Yes	Yes	CC	n/a	n/a	n/a	n/a	ongoing
Average/Share	5m	Mostly yes	Mostly don't know	11/14 CCs (incl. LC)	50%	0.5	52.2%	100%	20.5m

Sources: Staff reports and media reports; Asonuma, Niepelt and Ranciere (2019), Asonuma and Trebesch (2016), Cruces and Trebesch (2014), Das, Papaioannou and Trebesch (2012), Park and Samples (2021)

1/ According to the LIA policy this would normally include information on the assessed economic situation/financial circumstances, outline of a viable program, and a comprehensive picture of the proposed treatment of claims.

2/ Anthony, Impavido and van Selm (2020) for Barbados domestic debt episode. Staff calculations for Argentina and Ecuador (both 2020). Crusces and Trebesch (2013) for cases prior to 2014, Asonuma, Niepelt and Ranciere (2018) updated dataset for all remaining episodes. Weighted average (respect to debt outstanding) of instrument-specific NPV and market haircuts. NPV and market haircuts correspond to 1 - (PV of new bonds/PV of old bonds), and 1 - (PV of new bonds/Face value of old bonds), respectively.

3/ Based on Staff Reports, media reporting, and Park and Samples (2021). After application of CACs, where relevant

4/ 83 percent participation rate of existing holders, or over 90 percent excluding US-based investors who could not participate for legal reasons.

Annex III. The Evolution of the Fund's Lending into Arrears Policy

A. The Pre-1989 Policy

1. **Prior to 1989, the Fund had a non-toleration of arrears policy with respect to all creditors (private, official bilateral and multilateral) including with respect to sovereign arrears to private creditors.** To this end, the non-accumulation and elimination of arrears served as a general condition for the availability of Fund resources to members. The success of the policies was attributable, in part, to creditors' recognition that cooperation in the financing of Fund-supported programs was in their self-interest.

2. **In its original conception, however, the scope of the arrears policy was limited in two important respects.** First, the policy's coverage was limited to arrears on payments from residents to non-residents on current (and not capital) transactions; [1] and second, the policy applied to arrears arising from exchange restrictions and not to those arising from a government default on its own external obligations.[2] Against the background of a growing emergence of sovereign arrears, however, the policy was extended in 1980 to include such arrears, recognizing that payment arrears incurred by governments as a result of a default are as damaging to a country's credit standing and the effective functioning of the world's payments system as jurisdictional arrears. As a result, the Fund aligned its position on the elimination of sovereign and jurisdictional arrears, calling for their clearance both in the context of Fund-supported programs and the Fund's surveillance activities.[3]

3. **Against this background, in 1982 the Fund developed a policy on financing assurances to complement the arrears policy**.[4] Under this policy, the Fund requires, as a prior condition to the availability of financing under Fund arrangements, that other creditors (official and private) provide assurances that they would offer the necessary support (typically by restructuring of arrears and principal maturing during the program period and new financing) to fill the estimated gaps in the

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[1] Current payments are defined in Article XXX(d) of the Fund's Articles of Agreement to include not only payments due in connection with foreign trade and other current business, but also, and without limitation, "payments due as interest on loans and as net income from other investments" and "payments of moderate amount for amortization of loans."

[2] The Fund has held the position that a government cannot justify non-performance either as a principal debtor or guarantor by pleading the exchange control that the government itself has imposed. External arrears incurred by a government on its own debt are not evidence of exchange restrictions and are, therefore, outside the Fund's jurisdiction under Article VIII, Section 2(a). Review of Fund Policies and Procedures on Payments Arrears, August 1980.

[3] *Id.*

[4] See Financing Assurances in Fund-Supported Programs, December 1987;The Fund's Policy on Financing Assurances, April 1989; Concluding Remarks by the Chairman on Fund Policy on Sovereign Arrears to Private Creditors, March 1998;and Fund Policy on Sovereign Arrears to Private Creditors, January 1998.

financing of the program on terms consistent with the member's return to external viability.[5,6] As there were limits both to the degree of adjustment that could be undertaken by a member and the amount of financing that could be provided by the Fund, the absence of such financing assurances from other official and private creditors was considered to undermine both the viability of the program and the member's capacity to repay the Fund.

B. The 1989 Modification and the Introduction of the LIA Policy

4. In 1989, the Fund introduced the policy on lending into sovereign arrears to private creditors (LIA) as a limited exception to its general policy of non-toleration of arrears. Following the debt crises, financial institutions had gradually strengthened their balance sheets by the late 1980s, and had become increasingly reluctant to provide financing assurances required by the Fund, resulting in delays in the Fund's support for members' adjustment programs.[7] At the same time, the growing recognition that problems faced by many debtors were reflecting sustainability rather than liquidity, and that a comprehensive resolution of the debt difficulties might entail some debt reduction, reinforced the difficulty of reaching agreement on conventional financing packages. As a result of these developments, the Fund's policy of non-toleration of arrears had the unintended consequence of providing private creditors with leverage over debtors and Fund arrangements.

5. In view of these developments, the Fund modified its financing assurances and arrears policies with respect to external commercial banks to allow the approval of a Fund arrangement before commercial banks had provided assurances as to their willingness to support a financing package consistent with the program parameters. This modification of the policy was recognized to entail certain risks regarding the safeguard of Fund resources. To ease these concerns, the LIA policy required that approval of a Fund arrangement be granted only in cases where: (i) prompt Fund support was judged to be essential for the successful implementation of the member's adjustment program; (ii) negotiations between the member and its creditors had begun; and (iii) it could be expected that a financing package consistent with external viability would be agreed upon within a reasonable amount of time.

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[5] In practice, the Fund required a formal confirmation from a critical mass of creditor banks through their advisory committee. A critical mass was considered to be the level of participation that made the implementation of financing agreement virtually certain. The share of banks that constituted a critical mass was a matter of judgment on a case-by-case basis, but generally was over 90 percent. During the 1980s debt crisis, the acceptance of a term sheet by banks holding a critical mass of principal was considered as eliminating arrears and providing adequate assurances regarding commercial bank financing.

[6] While, in principle, the application of the Fund's policies on arrears and financing assurances has required that all private creditors participate in burden sharing, small private creditors with relatively small exposure (for example, bondholders and uninsured suppliers) had generally been excluded from this requirement for practical reasons.

[7] Summing Up by the Chairman on Fund Involvement in the Debt Strategy—Further Considerations, May 1998.

C. The 1998 and 1999 Modifications

6. **In 1998, the scope of debt to which the LIA policy could be applied was broadened to encompass international sovereign bonds and other debt to private creditors**.[8] Until then, the policy provided for lending into arrears only on debt to external commercial banks. However, as a result of changes in the composition of capital flows to emerging market sovereigns, international bonds replaced syndicated bank loans as the primary financing vehicle for sovereigns. In 1998, the LIA policy would include cases of arrears to sovereign bonds and Fund financing be provided on a case-by-case basis and only where (i) prompt Fund support was considered essential for the successful implementation of the member's adjustment program; (ii) negotiations between the member and its private creditors had begun; and (iii) there were firm indications that the sovereign borrower and its private creditors would negotiate in good faith on a debt restructuring plan. The first two criteria replicated the first two criteria of the 1989 policy, while the third criterion was intended to address specific concerns with regard to bond restructuring.

7. **In a further discussion of the LIA policy in 1999, it was recognized that private creditors might delay negotiations with sovereign debtors following a default for a variety of reasons**.[9] First, the heterogeneity of the creditor base could result in coordination difficulties, complicating the task of assembling a representative group. Second, the creditor base might include a large element that had no ongoing commercial interest in the sovereign debtor. As a result, the incentives to negotiate in order to return the debtor to good standing in the international financial community may be less than for commercial bank creditors of the 1980s who were generally seen as having a long-term business interest in the debtor country. Finally, given the magnitude of the financing available to emerging market borrowers, the outcome for debtors of losing market access was likely to be at least as serious as in the 1980s. There was also a concern that, if any combination of the above were to prevail, the Fund could be precluded from lending even if the member's policies were appropriate and Fund support was essential to the adjustment effort, since requirements (ii) and (iii) under the 1998 policy would not be met. In 1999, the Fund replaced these requirements with an assessment of whether the member was making good faith efforts to reach a collaborative agreement with its private creditors. The Fund retained the requirement for the criticality of prompt Fund support for the support of the authorities' adjustment program.

D. The 2002 Modification

8. **In 2002, the Board reviewed the application of the good faith criterion and provided procedural clarity in guiding the dialogue between debtors and their external private**

[8] Concluding Remarks by the Chairman on Fund Policy on Sovereign Arrears to Private Creditors, March 1998 and Fund Policy on Sovereign Arrears to Private Creditors, January 1998.

[9] Summing Up by the Acting Chairman on Fund Policy on Arrears to Private Creditors—Further Considerations, June 1999 and Fund Policy on Arrears to Private Creditors—Further Considerations, April 1999.

creditors, including in cases where representative creditor committees had been formed.[10] In particular, the Fund stressed the need to strike an appropriate balance between the greater clarity about the good faith dialogue between a debtor and their private external creditors to provide better guidance about the application of the LIA policy and the flexibility in applying the good faith criterion to accommodate the characteristics of each specific case. As under previous iterations of the LIA policy, all purchases made while a member has outstanding arrears to private creditors continue to be subject to financing assurances reviews, which will provide an opportunity for the Fund to monitor relations between a debtor and its external private creditors.

9. Directors agreed that Fund lending into sovereign arrears to private creditors (including bondholders and commercial banks) should be on a case-by-case basis and only where:

(i) prompt Fund support is considered essential for the successful implementation of the member's adjustment program; and

(ii) the member is pursuing appropriate policies and is making a good faith effort to reach a collaborative agreement with its creditors.

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

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

- Second, the member should share relevant, non-confidential information with all creditors on a timely basis, which would normally include:

    - an explanation of the economic problems and financial circumstances that justify a debt restructuring;

    - a briefing on the broad outlines of a viable economic program to address the underlying problems and its implications on the broad financial parameters shaping the envelope of resources available for restructured claims; and

    - the provision of a comprehensive picture of the proposed treatment of all claims on the sovereign, including those of official bilateral creditors, and the elaboration of the basis on

[10] Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion, July 2002 and The Acting Chair's Summing Up on Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion, September 2002.

which the debt restructuring would restore medium-term sustainability, bearing in mind that not all categories of claims may need to be restructured.

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

11. Although, as a general premise, the form of the dialogue would be left to the debtor and its creditors, under this approach a member in arrears would be expected to initiate a dialogue with its creditors prior to agreeing on a Fund-supported program consistent with the principles discussed above. In cases in which an organized negotiating framework is warranted by the complexity of the case and by the fact that creditors have been able to form a representative committee on a timely basis, there would be an expectation that the member would enter into good faith negotiations with this committee, though the unique characteristics of each case would also be considered. This formal negotiating framework would include, *inter alia*, the sharing of confidential information needed to enable creditors to make informed decisions on the terms of a restructuring (subject to adequate safeguards), and the agreement to a standstill on litigation during the restructuring process by creditors represented in the committee. By the same token, in less complex cases, where creditors have not organized a representative committee within a reasonable period, or where for other reasons a formal negotiation framework would not be effective, the member would be expected to engage creditors through a less structured dialogue.

Annex IV. Resolution of Official Arrears

1. To inform the review of the NTP and LIOA policies since 2015, staff has collected data on the resolution of official arrears that were subject to these policies. Data was gathered on the stock and creditor composition of official bilateral arrears in Fund arrangements between 2016–20, focusing on the stock immediately prior to each arrangement[1], and at the end of 2020. The main sources were staff reports, supplemented by information provided by Fund country teams.

2. A majority of debtor countries made some progress towards resolving their official bilateral arrears, but only a few resolved them fully (Table AIV.1). There were only four cases in which the arrears to which the LIOA/NTP applied were fully resolved, although in two of these arrears arose again before a subsequent Fund arrangement. In addition, eleven countries resolved arrears with some of their external bilateral creditors, which in most cases resulted in a substantial reduction in the stock of official bilateral arrears. Finally, eight debtor countries did not resolve the arrears with any of their official bilateral creditors, although in some of these there are ongoing negotiations. In this last group the arrears were generally OSI-related (often relating to the HIPC Initiative), and in most cases significantly predated the 2015 reforms, although there are a few exceptions.

[1] For Fund members with multiple Fund arrangements with official bilateral arrears during this period, the data on the initial stock of arrears was collected for their first Fund arrangement after 2015.

Table AIV.1. Evolution of Arrears to Official Bilateral Creditors in Fund Arrangements from 2016–20[1,2]

Debtor	Facility, Approval	OSI/Non-OSI	Basis for LIOA	Initial Arrears: Amount (US$ mn)	Initial Arrears: Date	Initial Arrears: Creditors	End-2020 Arrears: Amount (US$ mn)	End-2020 Arrears: Creditors
Original arrears fully resolved								
Barbados	EFF, 2018	OSI	Consent	1	Sep. 2018	CAN	0	n/a
Gabon	EFF, 2017; RFI, 2020	non-OSI	Non-objection	115	Jun. 2017	CAN, CHN, DEU, ESP, FRA, ISR, KOR	3[3]	CHN
Mongolia	EFF, 2017	OSI	Consent	6	Apr. 2017	CHN	0	n/a
Suriname	SBA, 2016	non-OSI	Non-objection	17	Jun. 2016	CHN	58[4]	CHN, FRA, IND, ISR, ITA, NLD, SWE
Some arrears clearance								
Central African Republic	ECF, 2017; ECF, 2019; RCF, 2020	OSI & non-OSI	Consent; 3 Criteria; Non-objection	192	Dec. 2015	ARG, GNQ, IRQ, LBY, SRB, TWN	215	ARG, GNQ, IRQ, LBY, TWN
Chad	ECF, 2017; RCF, 2020	non-OSI	Non-objection	61	Apr. 2017	COG, IND, SAU, KWT, LBY	90	COG, LBY
Comoros	RCF, 2020	non-OSI	Non-objection	2	Nov. 2019	FRA, IND, SAU, KWT,	1[5]	IND
Djibouti	RCF, 2020	OSI	Emergency financing	107	Mar. 2020	BEL, CHN, ESP, IRN, ITA, SAU, UAE	1[6]	IRN, UAE
The Gambia	RCF, 2017; ECF, 2020; RCF, 2020	OSI	Consent; 3 Criteria	17	Jun. 2017	CHN, VEZ	19[7]	VEZ
Grenada	ECF, 2016; RCF, 2020	OSI	Rep. PC; Consent; 3 Criteria	17	Dec. 2015	DZA, FRA, GBR, LBY, RUS, TTO, USA	23	DZA, LBY, TTO
Guinea-Bissau	ECF, 2016	OSI	Consent	109	Jul. 2016	BRA, DZA, LBY, PAK, RUS, TWN, UAE	39	BRA, DZA, LBY, PAK, RUS
Iraq	SBA, 2016	OSI	Rep. PC	40,563	Dec. 2015	BRA, EGY, JOR, SAU, KWT, MAR, PAK, POL, QAT, SDN, TUR, UAE	40,062	EGY, JOR, SAU, KWT, PAK, POL, QAT, SDN, TUR, UAE
Jamaica	EFF, 2016	OSI	Rep. PC	44	Dec. 2015	IRQ	21	IRQ
Serbia	SBA, 2016;	OSI	Rep. PC	75	Dec. 2015	CSK, LBY	n.a.[8]	LBY
Somalia	ECF/EFF, 2020	OSI	Rep. PC	3,708	Dec. 2018	BGR, DEN, DZA, FRA, ESP, GBR, IRQ, ITA, JPN, SAU, KWT, LBY, NED, NOR, ROU, RUS, TWN, UAE, USA	1,421	BGR, DZA, IRQ, SAU, KWT, LBY, ROU, RUS, UAE

Table AIV.1. Evolution of Arrears to Official Bilateral Creditors in Fund Arrangements from 2016–20 (concluded)

No arrears clearance								
Afghanistan	ECF, 2016	OSI	Rep. PC	10	Dec. 2015	IRN	10[9]	IRN
Burkina Faso	ECF, 2016	OSI	Rep. PC	79	Dec. 2015	CHN, CDI, LBY	84	CHN, CDI, LBY
Dem. Rep. of Congo	ECF, 2019	OSI	Rep. PC; Consent	48	Dec. 2019	DZA, NAM, RWA TWN,	48	DZA, NAM, RWA TWN,
Ethiopia	ECF-EFF, 2019; RFI, 2020	OSI	Rep. PC	538	Dec. 2015	BGR, LBY, SRB, RUS	538	BRG, LBY, SRB, RUS
Guinea	ECF, 2016; ECF, 2017	OSI & non-OSI	Rep. PC; Non-objection	89	Dec. 2015	BGR, IRQ, LBY, MAR, PRK, ROU, THA	102	BRG, IRQ, LBY, MAR, PRK, ROU, THA
Mozambique	RCF, 2019; RCF, 2020	OSI & non-OSI	Rep. PC; Non-objection	719	Dec. 2015	AGO, BGR, BRA, IRQ, LBY, POL	722	AGO, BRA, BRG, IRQ, LBY, POL
Sao Tome and Principe	ECF, 2019	OSI & non-OSI	Rep. PC; Non-objection	11	Oct. 2019	BRA, DZA, GNQ	11	BRA, DZA, GNQ
Ukraine	EFF, 2016; SBA, 2019; SBA, 2020	OSI	3 Criteria	3,000	Dec. 2015	RUS	3,000	RUS

[1] Arrears figures are based on reporting by debtor countries, and generally do not include any accrual of additional interest.

[2] Jordan is not included, since the authorities represented a dispute as to the validity of the official arrears reported during its 2016 EFF arrangement.

[3] *Gabon:* Original arrears were cleared, but new arrears arose ahead of the 2020 RFI.

[4] *Suriname*: Latest arrears are as of August 2021; 2016 arrears were resolved, but Suriname has since gone into restructuring.

[5] *Comoros*: Most arrears were regularized under DSSI, discussions with India are ongoing.

[6] *Djibouti*: Remaining arrears relate to technical and diplomatic issues.

[7] *The Gambia*: A claim where the authorities represent a dispute with Libya is not included in these figures.

[8] *Serbia:* The amount of arrears owed to Libya at end-2020 is not available, as it is subject to a dispute.

[9] *Afghanistan*: The Fund's engagement has been paused since August 2021 as there continues to be a lack of clarity within the international community regarding the recognition of a government for Afghanistan.

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