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The IMF's role in sovereign debt restructurings

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Contents

Abstract 3

Executive summary 4

Introduction 7

1 The IMF's lending framework 12

1.1 Assessing debt sustainability 13

1.2 Exceptional access policy 16

Box 1 The Fund's exceptional access policy: from 2002 to the present day 17

1.3 Lending into arrears policies 20

2 The Fund's role in supporting debt transparency 27

3 The role of the IMF in the institutional setting of the sovereign debt restructuring architecture 30

4 The Fund's role in promoting contractual standards and monitoring legislative developments 35

4.1 Uptake of enhanced CACs 36

4.2 Recent experiences with CACs: Ecuador and Argentina (2020) 36

Box 2 Redesignation and "PAC-man" strategies 37

4.3 The way forward with CACs 37

4.4 Pros and cons of possible state-contingent debt instruments 38

4.5 Monitoring "anti-vulture fund" legislation 40

References 42

Annexes 49

A.1 – Debt sustainability assessment: main innovations of the new Sovereign Risk and Debt Sustainability Framework for Market Access Countries 49

A.2 – Argentina 2018-19. Exceptional access criteria and financing assurances 51

A.3 – The Fund's lending into arrears policies 52

A.4 – Comparability of treatment, as defined by the Paris Club 54

A.5 – A taxonomy of state-contingent debt instruments 55

List of abbreviations 57

List of Task Force members 58

Abstract

The global recession caused by the COVID-19 pandemic and the resulting deterioration in many countries' public finances have increased the risk of sovereign debt crises. Although crisis prevention remains paramount, these developments have made it imperative to re-examine the adequacy of the current toolkit for crisis management and resolution, in a context where changes in the creditor base and in the composition of public debt instruments have brought about new challenges in terms of reduced transparency and additional barriers to achieving inter-creditor equity. This report focuses on the international architecture for sovereign debt restructurings (SODRs), as seen through the lenses of the International Monetary Fund (IMF or "the Fund") and with a special attention to the role that the Fund can play in facilitating orderly restructuring processes. It provides a set of findings and recommendations in relation to certain key elements of the Fund's lending framework that have important ramifications on SODR processes, namely debt sustainability assessments (DSAs), the exceptional access policy (EAP) for financing above normal access limits, and the criteria for lending to countries with payments arrears to private creditors (LIA) or official bilateral creditors (LIOA). It also considers other indirect channels through which the Fund can affect SODRs, including its support for enhancing the transparency and public disclosure of sovereign debt information, its collaboration with the Paris Club and the G20 debt-related initiatives, the promotion of contractual standards for sovereign debt, and the monitoring of relevant legislative developments.

Keywords: International Monetary Fund, sovereign debt, sovereign default, debt restructuring regime

JEL codes: F34, F55, H63

Executive summary

This report focuses on the international architecture for sovereign debt restructurings (SODRs), as seen through the lenses of the International Monetary Fund and with a special attention to the role that the Fund can play in facilitating orderly restructuring processes. While in the recent past there have been a few cases of relatively orderly restructurings, new SODR cases are emerging that will be addressed via the G20 Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative (G20 Common Framework). Yet other SODRs may be expected in the future, mostly in connection with the impact of the COVID-19 crisis on public finances worldwide, which has fuelled the growing trend of public debt against the backdrop of a persistently favourable global financial cycle. Will the current architecture remain broadly appropriate for managing future SODRs in an orderly manner? Should it be updated or supplemented with additional supporting elements in order to better cope with newly emerging challenges? These are the questions on which this report focuses.

New challenges to orderly SODRs have emerged, in terms of changes in the creditor base and in the composition of public debt instruments. These developments have a clearly negative impact on debt transparency and disclosure, which in turn makes it more difficult to achieve inter-creditor equity in a restructuring context. A great deal of these issues would be better addressed if the newly emerging official creditor countries agreed to become full members of the Paris Club, or participated in an augmented format of that body under the umbrella of the G20 Common Framework – the prospects of which are unclear at this juncture. In addition, the lack of a comprehensive statistical picture of these phenomena makes it impossible to gauge with certainty the actual degree of pervasiveness of these challenges. These problems are most likely to be very important for low-income countries (LICs), though they may also be relevant to middle-income or more developed countries.

Against this background, it is important that the IMF supports efforts to improve debt transparency and disclosure, and focuses on a consistent implementation of its relevant policies. Indeed, the IMF plays a very important part in addressing a number of challenges (both perennial and emerging), mainly via its lending framework, but also through its support for enhancing the transparency and public disclosure of sovereign debt information, its collaboration with the Paris Club and G20 debt initiatives, the promotion of contractual standards for sovereign debt, and the monitoring of relevant legislative developments. **Our main findings and recommendation include the following.**

- **On assessing debt sustainability** – Debt sustainability assessments (DSAs) play an especially important role in the IMF's lending framework. Rigorous DSAs help identify cases of unsustainable debt that require a prompt and definitive debt restructuring – thereby contributing to timelier and more orderly debt restructurings. It is important to ensure that the new DSA framework for

market-access countries is implemented consistently. This includes a suitable treatment of regional spillovers, an adequate visibility of DSAs in staff reports, realistic growth and output gap forecasts, and frank discussions of programme risks, with clear messages on how to address these risks through appropriate safeguards. While the analysis of sovereign risks and DSA write-ups need to be sufficiently transparent to be useful, it is also necessary to ensure that the public disclosure of DSA information does not generate unintended side effects through adverse market reactions.

- **On the IMF's exceptional access policy (EAP)** – In order for sovereign debt crises to be tackled effectively, with the help of the IMF, it is essential to avoid the build-up of excessive Fund exposure – which is "super-senior" due to its de facto preferred creditor status. This also reduces the risk of countries receiving financial assistance becoming unable to repay the Fund. The 2016 reform of the EAP, including the removal of the "systemic exemption clause", was a step in the right direction. However, the revised policy still retains ample room for flexibility when addressing those "grey zone" cases where debt sustainability cannot be stated with high probability. Nonetheless, when debt sustainability is particularly uncertain, it is crucially important to stress the need for a more rigorous application of the exceptional access criteria, and for the Fund to seek firmer financing commitments from other sources and broader burden sharing among creditors. In the spirit of the 2016 EAP reform, the IMF should continue to explore the circumstances under which debt reprofilings (i.e. short extensions of debt maturities), combined with Fund-supported programmes, would be appropriate and necessary to improve debt sustainability, and ensure that countries in the EAP's "grey zone" are able to repay. In the absence of convincing arguments about the sufficiency of a reprofiling, and in the presence of significant uncertainties about the availability of financing from other creditors, a case could be made that these countries would be better served by a more ambitious debt restructuring in line with that envisaged by the EAP for "red zone" countries.

- **On the Fund's lending into arrears (LIA) policies** – Regarding lending to countries with payment arrears vis-à-vis their private creditors, the past application of the policy has been uneven and has varied considerably in the coverage of debtor-creditor relations. Assessing compliance with the criterion of "good faith" negotiations was particularly challenging in the case of Argentina (2003), which also raised the question of whether the LIA's requirements remain appropriate in light of the increased complexity of the creditor base. On the other hand, the 2015 LIOA policy (which pertains to arrears vis-à-vis official creditors) has worked well, by preventing individual official creditors from imposing an undue veto on Fund financing. The good faith criterion, which is common to both policies, should be retained, but there is scope to enhance the transparency of its application including with more detailed standards to describe its three dimensions (early dialogue, timely sharing of relevant information, and opportunity for creditors' input). Moreover, the "information sharing" dimension of the good faith criterion may provide a convenient means to support the international community's efforts to enhance debt transparency.

In particular, the IMF could clarify that sovereign debtors, acting in good faith, are expected to make public a comprehensive picture of the planned treatment of their domestic and external debts, including those vis-à-vis official bilateral and private creditors.

- The growing complexity of the creditor base may have increased the challenges of forming representative creditor committees, but the expectation of dialogue with one or more of this kind of committee remains valid, also as a demonstration of good faith behaviour. More importantly, the rise of new creditors represented by profit-seeking corporations, fully owned or controlled by governments that are not full members of the Paris Club, poses two major problems. First, in connection with the applicability of the good faith criterion, it would be desirable to clarify whether the presence of "dominant" foreign creditors that can negotiate their own deal at patently more favourable terms than the other creditors would represent a circumstance hindering Fund financing or not. Second, it is necessary to clarify the status of their claims (official vs. private) and determine whether these entities should be subsumed under the LIA or LIOA policies.

- **On the Fund's role in supporting debt transparency** – The IMF's support for the international efforts to enhance public debt transparency and disclosure is as welcome as it is necessary. The upcoming Review of Data Provision to the Fund for Surveillance Purposes, in 2021, will offer an important opportunity to broaden the minimum data provision obligations on public debt. At the same time, the IMF should further promote the full and rapid implementation of the Voluntary Principles for Debt Transparency, developed by the Institute of International Finance (IIF), and collaborate closely with the OECD and IIF on the debt data repository being created for private creditors' claims, to better understand the data collected through this initiative, and ensure that they can be used for its lending and surveillance activities.

- **The Fund's role in promoting contractual standards and monitoring legislative developments** – The IMF should continue to endorse the adoption of enhanced collective action clauses (CACs) that include the single-limb voting mechanism, in international sovereign bonds issued under all jurisdictions. In addition, the IMF should (a) promote the inclusion of enhanced CACs in international bond contracts of sub-sovereign entities and state-owned enterprises, (b) continue to monitor concrete cases of sovereign debt restructuring in the future, and (c) assess whether the lack of majority restructuring provisions in syndicated bank loans could adversely affect these processes; if this is the case, the IMF could propose the adoption of appropriate provisions. Finally, the IMF should further consult with the private sector and sovereign debt managers about the potential benefits of state-contingent debt instruments (SCDIs), particularly in regard to their role in helping low-income countries to overcome natural disasters: as LICs' climate vulnerability is high, the development of this type of instrument in the event of natural disasters could minimise the risk of over-indebtedness while reinforcing financing resilience.

Introduction

The global recession caused by the COVID-19 pandemic and the resulting deterioration in many countries' public finances have increased the risk of sovereign debt crises. Although crisis prevention remains paramount, these developments have made it imperative to re-examine the adequacy of the current toolkit to manage and resolve sovereign debt crises in an orderly way. Sovereign debt restructurings (SODRs), which are a recurrent feature of the international financial landscape, can indeed become very lengthy and disorderly, and inflict unwarranted damage on debtors and creditors alike. In the absence of an internationally accepted bankruptcy framework to address sovereign insolvencies, sovereign debt workouts continue to be implemented on a case-by-case basis, taking into account the legal and financial features of sovereign debt contracts (which are determined by the market practices and legal standards prevailing in major financial jurisdictions), and often in the context of well-established official frameworks such as the Paris Club. The IMF is almost always involved in these restructurings, given its quasi-universal membership and long-standing experience in dealing with these events drawing on well-tested practices and tools for crisis prevention and resolution.

Recent SODR cases (including Argentina and Ecuador in 2020) give seemingly contrasting signals. On the one hand, these cases were managed in a relatively quick and smooth fashion compared to earlier instances; importantly, they did not generate the pervasive and disruptive contagion effects observed for sovereign debt crises in the 1990s, thereby confirming the trend prevailing over the last two decades (Didier et al, 2006). The idiosyncratic rather than systemic nature of sovereign debt restructurings is in principle a welcome development. The factors contributing to this development are likely to include the marked improvement in emerging market economies' (EMEs) economic fundamentals and policy frameworks, in terms of more widespread use of: flexible exchange rates, higher credibility of inflation targeting regimes, larger stocks of FX reserves, and more effective regulation and supervision of domestic financial systems. Another contribution might have been provided by a stronger and more diversified global financial safety net (GFSN), with greater financial "firepower" for the IMF and strengthened regional financing arrangements, alongside a more broad-based network of central bank bilateral agreements for the provision of international liquidity.

On the other hand, lack of contagion may also reflect the influence of cyclical factors. In particular, the accommodative global financial conditions in response to the global financial crisis have made it easier for EMEs (as well as for low-income countries, LICs) to service their debts, while at the same time underpinning a sizeable increase in overall indebtedness, even before the COVID-19 crisis. By triggering a further generalised increase in debt-to-GDP ratios, the pandemic has again increased the risk of a systemic sovereign debt crisis, thus rekindling the question of whether there is a need for specific mechanisms to address this type of crisis. Moreover, the pandemic has hit many developing countries (mostly LICs) the hardest – several of

which were already classified by the IMF/World Bank as “at high risk of debt distress” or “in debt distress”. The latter precipitated important and innovative G20 initiatives on two related fronts: first, a temporary moratorium on the debt service payments of LICs – the Debt Service Suspension Initiative (DSSI); and second, a set of agreed principles and modalities for restructuring their sovereign debt on a case-by-case basis where needed – the Common Framework for Debt Treatments beyond the DSSI (G20 Common Framework). The discussions accompanying these G20 initiatives touch upon several important aspects of sovereign debt restructurings (including creditor coordination, debt transparency, debt sustainability, and inter-creditor equity), which may be relevant to a broader class of debtors, e.g. to EMEs, if not to advanced economies.

The purpose of this report is to assess whether the current sovereign debt restructuring architecture, and in particular the IMF’s role within it, remains broadly appropriate to facilitate smooth, timely and predictable workouts, or whether it needs to be updated or supplemented with additional supporting elements in order to better cope with newly emerging challenges. Central banks have an interest in ensuring that their own domestic financial systems work in a smooth fashion; more generally, they are interested in all forms of international cooperation that can enhance the stability of the international monetary and financial system at large. Disorderly SODRs can have a negative impact on such stability, and therefore there is merit in investigating how the IMF can contribute, both in theory and practice, to timely and orderly debt workouts when circumstances make them unavoidable. Besides, in consideration of the direct stake of many central banks in the Fund’s resources and the need to preserve the reserve asset status of central banks’ positions vis-à-vis the Fund, it is important that any IMF lending in the context of SODR processes ensures adequate safeguards for the Fund and does not jeopardise its financial integrity and risk profile, as mandated by the Fund’s statutes and risk management framework.

The literature on sovereign debt identifies five challenges that may hinder timely and orderly debt restructurings:

(a) *Sovereign debtors may have incentives to delay the restructuring*, fearing the related economic and reputational costs, and reflecting the typically limited time horizon considered by the authorities (and their creditors) to take political and financial decisions. The resulting “gamble for redemption” tends to worsen the economic situation of the debtor, and therefore reduces the amount of available funds (the “resource envelope”) to service sovereign debt when the restructuring eventually starts.

(b) There exists an *information asymmetry about countries’ capacity to repay* (and in recent times also about the creditor base and the variety of financial assets eligible for restructuring; see below). As debtors are supposed to have a better knowledge of such capacity than their creditors, the latter may distrust the debtor’s restructuring offers as purposely low and unfair. As a result, negotiations may become more conflictual and take more time to resolve.

(c) *Creditors may also question the authorities' willingness to implement the policy adjustment* needed to enhance the debtor's repayment capacity and facilitate the restructuring deal once the latter is agreed. In principle, any such implementation failures should be sanctioned ex post with a longer exclusion from capital markets. However, experience shows that this may not necessarily be the case. As a result, perceived lack of commitment may make creditors more hesitant to accept a restructuring deal ex ante, and may translate into lengthier and more controversial negotiations.

(d) While negotiating the terms of a restructuring, it may be difficult for debtors to raise new debt from third-party sources (either private or official). Such "interim finance" may be indispensable to avoid destroying value in the process, but no mechanism is in place to ensure its seniority over the outstanding debt under restructuring negotiations. *This lack of "debtor in possession financing"* can deepen the crisis and, again, lower the resource envelope available to the parties involved.

(e) Finally, debt workouts can become more problematic when creditors fail to coordinate among themselves. This may happen when creditors are many and diverse ("atomistic"); when some creditors believe that they would be in a better position to fully recover the value of their claims by not accepting the debtor's offer (the "*holdout problem*"); or when they perceive to get a discriminatory treatment vis-à-vis other classes of creditors (*lack of inter-creditor equity*). As a result, a restructuring offer could be rejected even when accepting it would be in the creditors' collective interest.

Going forward, problems under (b) and (e) may become more acute because of two recent developments in the financial landscape. First, *the creditor base has changed*, with the emergence of new official bilateral creditors and their profit-seeking corporations acting outside the Paris Club or other informal bodies for creditor coordination. Second, *the variety of financial instruments potentially eligible for a restructuring is now larger than before.* This is especially true for loans, which tend to be more opaque and non-standardised compared to sovereign bonds (e.g. with the use of collateral provisions that are not visible in the available data).

These developments may have a negative impact on SODR processes, along two related dimensions. First, reduced *debt transparency* (not only in relation to the debtor's capacity to repay, but also the creditor base and the financial instruments potentially eligible for restructuring) complicates the strategies pursued by sovereign debtors, their private creditors, and the official sector (including the IMF). Second, ensuring *inter-creditor equity* may have become more difficult than before, reflecting the greater variety of financial claims and the different bargaining power enjoyed by creditors in restructuring negotiations.

The IMF is only one component – albeit a very important one – of the current SODR architecture, which also includes the Paris Club and other informal fora for creditor coordination and debtor-creditor dialogue, as well as a panoply of contractual and other legal frameworks for undertaking debt restructurings in concrete cases.

The IMF can contribute to orderly sovereign debt restructurings in several ways, both directly and/or indirectly. First, its policies and tools help address the issues referred to above, under points (a) to (d). The most important of these policies include the two frameworks for assessing countries' debt sustainability (DSA) for market access countries (MACs) and low-income countries (LICs), the Fund's lending policies (including the exceptional access policy (EAP) and the financing assurances policy), and the criteria for lending to countries with payments arrears vis-à-vis private creditors (LIA) as well as official bilateral creditors (LIOA). Second, the Fund has an indirect role to play as a global advisor on legal, financial, and architectural matters that may affect sovereign debt restructurings, as well as through the promotion of desirable standards for sovereign debt contracts and by monitoring pertinent legislative developments. Third, as emphatically stated in its Articles of Agreement, the Fund is a "permanent institution which provides the machinery for consultation and collaboration on international monetary problems", and therefore may facilitate the debtor-creditor dialogue as an independent advisor.

Broadly speaking, the policies of the IMF play a role in both the prevention and management/resolution of sovereign debt crises, by modifying the incentives faced by sovereign debtors and their creditors. These policies purport to: (i) *reduce the "incentive to delay"*, by identifying unsustainable debt situations and clarifying the conditions under which the country should expect to receive IMF support; (ii) *anchor debtor-creditor negotiations to debt sustainability assessments resting on domestic policy adjustment*, which help to delineate the realistically feasible resource envelope as well as the debtor's payment capacity; (iii) *offer a "commitment technology"* based on programme conditionality, "reviews" and the phased disbursement of financing, to reassure creditors about the domestic policy adjustment to be implemented throughout the programme horizon; and (iv) *provide "interim finance"* via IMF loans that endeavour to "catalyse" financing from other sources.

Despite multiple channels through which the IMF can affect SODRs, there are limits to what the Fund can do. To begin with, IMF loans themselves are excluded from these restructurings, given the Fund's institutional setup and unique financing model, reflected in its preferred creditor status (PCS). *The preservation of this status, which is de facto and not de jure, is an overarching priority for the IMF and its shareholders.* Also, the IMF does not "micro-manage" SODRs, i.e. it has always refrained from being directly involved in debtor-creditor negotiations, in the belief that the decisions about what to restructure, how and by how much, ultimately rests solely with the sovereign debtor and its creditors. Importantly, the Fund's role remains that of a neutral facilitator – drawing on its expertise and technical assistance capabilities – between the debtor and its creditors, without taking sides or a position itself on the details of a restructuring.

The term "sovereign debt" will be used flexibly throughout this report, to encompass different definitions of the debtors involved. Indeed, a proper assessment of sovereign debt issues requires going beyond the narrow boundary of "central government". Depending on the question under scrutiny, it may be necessary to consider other entities classified as part of the "general government"

sector (i.e. state and local government), as well as those financial and non-financial corporations classified as "public"– which are part of the broader "public sector" together with the general government institutions (IMF, 2014d). For example, these latter corporations may generate contingent liabilities for the sovereign, which must be duly taken into account in preparing debt sustainability assessments. At the same time, there is a need to broaden the analysis of the creditor side of a SODR and consider new classes of creditors represented by profit-seeking corporations fully owned or controlled by their government, which clearly belong to the public sector and can create problems of debt transparency and creditor coordination: see sections 2 and 3.

Another important caveat concerns the notion of "sovereign debt restructuring" used in this report. Most of the policies and tools discussed here are designed to address the restructuring of sovereign debt issued under foreign jurisdictions and governed by foreign laws, not domestic ones. Sovereign domestic debt may be comparatively easier to restructure from a legal perspective, because the sovereign may change the relevant rules of the game (the restructuring of the Greek debt in 2012 is a case in point). However, domestic debt may pose bigger problems in terms of domestic financial stability. Thus, in concrete cases, the sovereign debtor may have to choose the appropriate mix of external and domestic debt to be restructured.

This report is organised as follows. In Section 1, we examine how the Fund's lending framework has responded to recent shocks and developments (including the headline-grabbing case of Argentina), with specific attention to three main components: debt sustainability assessments, the exceptional access policy and the lending into arrears policies. In Section 2, we discuss the modalities of possible IMF contributions to international efforts to enhance the disclosure and transparency of information on sovereign debt. The institutional aspects of the current sovereign debt restructuring architecture are discussed in Section 3, which focuses on the IMF's interactions with the Paris Club and the G20 Common Framework, and investigates the role that the Fund may play to strengthen these processes. Finally, in Section 4, we discuss the Fund's role in the promotion of appropriate contractual standards to facilitate SODR processes; in addition, we will briefly examine the pros and cons of possible state-contingent debt instruments, and some recent legislative initiatives involving "statutory" elements, i.e. "anti-vulture funds" legislation.

1 The IMF’s lending framework

The IMF’s lending framework comprises a broad set of analytical tools and policies clarifying the modalities and procedures to follow when a member country asks to access the available financing facilities. The key objective is to assist members in resolving their balance of payments problems and restore macroeconomic viability, while at the same time establishing adequate safeguards for the temporary use of IMF resources as mandated by Article V, Section 3(a). These rules and tools are subject to regular reviews to check their continued effectiveness.

All the elements of the Fund’s lending framework have, to a varying extent, a risk-mitigating objective. Indeed, they try to conjugate the demand for IMF financing with the need to support its catalytic role, and preserve its liquidity and the revolving nature of its resources – in particular by reducing the risk that countries receiving financial assistance become unable to repay the Fund. This usually requires containing the build-up of excessive debt (including with the IMF, whose claims are super-senior and thus non-restructurable), which may create debt service challenges or adversely affect a country’s access to private capital markets.[1] At the same time, part of this framework also aims at minimising, if not overcoming, the hurdles to orderly and timely SODRs outlined in the Introduction.

This section focuses on the key policies and analytical tools that have the most important ramifications on SODR processes: debt sustainability assessments (DSAs), the exceptional access policy (EAP) for IMF financing above normal access limits, and the policies for lending to countries with payments arrears to private creditors (LIA) or official bilateral creditors (LIOA). This section describes the key features of these elements, and discusses how well they have fared since their last review.[2]

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[1] In particular, excessive Fund exposure may discourage new financing from private creditors or, even worse, may trigger “capital flights” that would severely complicate any debt restructuring required later. Failure to catalyse third-party financing could intensify pressures for the IMF to grant “roll-over” programmes (i.e. to finance repayments to itself and prevent potential arrears) when external viability has not been restored. This in turn may raise questions about the temporary character of IMF financial assistance and the revolving nature of Fund resources. For recent studies on the catalytic effect of IMF financing, see Krahnke (2020), and Maurini and Schiavone (2021).

[2] For brevity’s sake, we do not dwell on other risk-mitigating elements of the overall lending framework, such as the determination of normal access limits, the surcharges policy, and the financing assurances policy. Normal access limits set the threshold above which IMF support is subject to enhanced scrutiny via the EAP. They are expressed in annual and cumulative terms, and determined separately through dedicated reviews (see, for example, IMF, 2016b). Surcharges depend on the amount and duration of outstanding IMF credit; they are designed to generate income to allow the IMF to accumulate precautionary balances and to discourage large and prolonged use of IMF resources. Finally, according to the financing assurances policy, all Fund programmes need to be financed for the upcoming 12 months, and there need to be good financing prospects for the rest of the programme period. Next to being another risk-mitigating tool, this policy underpins the catalytic role of the Fund. If successful, it demonstrates that the parameters of IMF-supported arrangements are shared by other official and private creditors, thereby increasing the chances of leading to a more stable outcome. For a description of the policy on financing assurances and how it interacts with the Fund’s policies on arrears, see IMF (2013), Annex I. “Fund Policies on Financing Assurances and External Arrears”, pp. 43-45.

1.1 Assessing debt sustainability

Debt sustainability assessments (DSAs) occupy a prominent position in the Fund's toolkit. They are an essential component of its lending framework and also provide important inputs to IMF surveillance. With regard to Fund lending, DSAs represent a key diagnostic tool that underpins the decision to provide – or refuse – IMF financing. Indeed, under Article V, Section 3 and other relevant Fund policies[3], *the Fund is precluded from financing countries with an unsustainable debt*, unless steps are taken to address the problem in a manner that restores sustainability and that will lead to renewed market access. Rigorous DSAs help identify cases of unsustainable debt that require a prompt and definitive restructuring; in this way, they can contribute to making these restructurings timelier and orderly. In all cases, DSAs help to define credible (i.e. politically and economically feasible) domestic adjustment strategies for maintaining or restoring debt sustainability, and to determine the appropriate amount of financing required from third parties (private and official). For all these reasons, DSAs contribute to mitigate the financial risks attached to IMF lending. At the same time, well-structured and transparent DSAs have the potential to reduce information asymmetries, facilitate debtor/creditor engagement, and attenuate the incentives for "too little, too late" restructurings.

To sum up, DSAs feed into the Fund's lending framework in several important ways. First, as noted earlier, they are required in all cases of IMF lending, irrespective of the related access levels. Second, they represent an indispensable tool for analysing various risks attached to Fund-supported programmes, which is particularly important for exceptional access financing. In particular, DSAs would help to gauge: (a) the effects of any possible policy slippages affecting central policy scenarios; (b) the realism of the assumptions made on key macroeconomic and financial variables; and (c) the plausibility of financing assurances requested for IMF lending, including an assessment of rollover risks.[4] Finally, DSAs provide important indications about the resource envelope available in a sovereign debt restructuring, and therefore underpin the Fund's lending decisions in both pre and post-default contexts.

In the current context of increasing debt levels and heightened uncertainty, DSAs have become more challenging. DSAs are an eminently probabilistic exercise, which rarely delivers clear black-or-white judgements. DSA results may often fall in an intermediate "grey zone", which requires careful consideration of

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[3] See Guidelines on Conditionality, Paragraph 6: "Fund-supported programs should be directed primarily toward the following macroeconomic goals: (a) solving the member's balance of payments problem without recourse to measures destructive of national or international prosperity; and (b) achieving medium-term external viability while fostering sustainable economic growth." Decision No. 12864-(02/102), 25 September 2002, as amended by Decision No. 13814-(06/98), 15 November 2006. Published in *Selected Decisions and Selected Documents of the International Monetary Fund*, 40th Issue, IMF, 30 April 2019, p. 286.

[4] The assessment of prospective financing from other sources (and, more in general, the estimation of financing needs under a programme) can be subject to considerable uncertainty. In order to safeguard against the risk of a shortfall in programme financing in the baseline scenario, it is crucial that there are firm commitments for financial contributions in place at programme inception.

additional safeguards for ensuring the financial viability of a Fund-supported programme.

The IMF has developed separate analytical frameworks for market-access and low-income countries (the *MAC DSA* – introduced in 2002 and revised in 2013 – and the IMF-World Bank *LIC DSF* – introduced in 2005 and revised in 2017–, respectively). This dual approach was dictated by the need to tailor debt sustainability analyses to the specific circumstances of these country groups: as a result, the two frameworks have several features in common but also important institutional differences.[5] The MAC DSA was revamped in mid-January 2021, and renamed "Sovereign Risk and Debt Sustainability Framework for Market Access Countries" (*MAC SRDSF*; see IMF, 2021).

The new MAC SRDSF has strengthened the existing DSA framework with a number of important innovations aimed at: (a) improving its capacity to predict sovereign stress for surveillance purposes, (b) providing better disclosure and coverage of debt-related risks, and (c) enhancing the transparency and communication of DSA results (see Annex A.1 for a synthetic description of these innovations). These reforms have strengthened the links between DSAs and the lending policies of the Fund, by relying on a "*three-zone" assessment* that distinguishes cases where debt is "sustainable with high probability" (so-called "green zone"), "sustainable but not with high probability" ("grey zone"), and "unsustainable" ("red zone").

The new MAC SRDSF is expected to obviate some of the drawbacks that have emerged since the last MAC DSA review in 2013. A recurrent – although relatively minor – problem with DSAs was their *persisting lack of visibility and integration* into the main text of staff reports. DSAs were too often confined to the appendix of these reports, with limited discussion of their findings in the main text. In the most controversial case of the 2018 programme with Argentina, this problem was combined with *over-optimistic DSA assumptions* (including on growth rates) and an inadequate *representation of FX risks* for a country whose external debt was (and remains) denominated in US dollars (for more on Argentina, see Section 1.2*). Narrow debt coverage* also remained an issue, as well as insufficient information on debt-related risks, hampering informed decisions. According to the latest review report, while most advanced economies report at least on a general government basis, around two-fifths of EMEs still report on a central government basis only.

The new approach is yet to be implemented, and therefore it is not possible at this juncture to formulate a view on its concrete results. The rollout of the MAC SRDSF is planned to start in late 2021/early 2022; the Fund's staff will prepare a

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[5] The MAC DSA has been developed by the IMF and applies to countries that principally receive financing through market-based instruments and on non-concessional terms on a durable and stable basis. In contrast, the LIC DSF was developed jointly by the IMF and the World Bank. It applies to all - countries eligible for the Poverty Reduction and Growth Trust (PRGT) that also have access to International Development Association (IDA) resources, and to all countries eligible for IDA grants. These countries mainly rely on concessional financing, and sustainability assessments typically focus on the present value of their debt (IMF, 2017c and 2018a). The LIC DSF classifies risk of debt distress in four categories ("low", "moderate", "high", or "in debt distress") used for determining the eligibility to IDA grants or access to Fund facilities (concessional and non-concessional) as prescribed by the Policy on Public Debt Limits in IMF-Supported Programs (IMF, 2020c).

Guidance Note and new reporting templates, to clarify remaining issues and ensure that the framework is implemented in an even-handed manner across the membership. Moreover, the new framework presupposes the existence of adequate systems for collecting and managing debt information at the national level; in several cases, this will require the provision of adequate technical assistance for capacity development (on this point, see also Section 2 on the Fund's role in enhancing debt transparency).

Looking ahead, some issues deserve to be carefully monitored when implementing the new DSA framework. There is a need to *clarify the technical treatment of regional spillover risks within a currency union*. The default specification of the near-term risks tool does not cover these risks, but may consider them – if this is justified on a case-by-case basis. Staff may want to specify in its forthcoming Guidance Note the criteria for determining whether the consideration of such risks would be necessary.

It will be crucial that these reports contain *frank and realistic discussions of programme-related risks*, especially in the most problematic cases, with clear messages about how to address these risks through appropriate safeguards. It will also be important to ensure that the *systematic bias in DSA growth and output gap forecasts* is addressed effectively by the IMF, and that DSAs are granted *adequate visibility and integration* in staff reports.

At the same time, while the analysis of sovereign risks and write-up of DSAs needs to be sufficiently transparent to be useful, it is imperative to *make sure that the public disclosure of DSA information does not generate unintended side effects*. The 2021 MAC SRDSF has brought important changes, but remains rightly cautious on potential adverse market reactions. In particular, full public disclosure of three-zone assessments has been allowed only for exceptional access programmes; in a surveillance context, public disclosure would be limited to exclude near-term risks. These modalities will be reconsidered after a 12-month trial period.

The newly approved DSA framework applies to surveillance or lending programme situations. It is silent on the idea of publishing, on a case-by-case basis, "preliminary" DSAs in a pre-default restructuring context, outside of an IMF programme. The only precedent of this sort (i.e. of a DSA being prepared and published outside a surveillance or lending context) was the publication of Argentina's DSA in 2020, as part of a technical assistance (TA) package requested by the authorities[6], and in the absence of any discussions on a possible Fund-supported arrangement. At the time, the Argentine authorities were set to engage in debt restructuring negotiations with their external private creditors. Ex post, according to some commentators, that publication paved the way for a swift conclusion of those negotiations. However, it also raised significant governance issues within the Fund, because TA reports are normally not discussed and endorsed by the Executive Board, and require only the member's consent (and not

[6] In March and June 2020, the IMF published, at the request of the country's authorities, two technical notes on Argentina's debt sustainability. The March technical note clarified that it neither represented the views of the IMF's Executive Board, nor signalled any implications for future IMF financing. See IMF (2020a).

the Board's) to be published (see Article V, Section 2(b)). Furthermore, the IMF could not play its core role through a programme, thereby postponing necessary macroeconomic adjustments.

The idea of publishing "preliminary" DSAs in a SODR context remains controversial. As a bare minimum, it would require a well-specified set of circumstances to work properly without creating governance conflicts inside the IMF – as happened with Argentina in 2020. In particular: (a) the member should have already made a request for a Fund-supported programme; (b) programme negotiations should be at an advanced stage; (c) the DSA should be discussed by the Board, and published with the Board's approval and the member's consent. Under these assumptions, the Board could decide to publish a "preliminary" DSA, if this were considered worthwhile. From a substance point of view, however, the disclosure of preliminary DSAs has its pros and cons. On the one hand, public disclosure in a SODR context might have beneficial effects on debt restructuring processes, by anchoring debtor-creditor negotiations around a plausible scenario prepared by staff with relevant expertise, without generating particularly adverse market reactions. On the other hand, the reliability of preliminary DSA results may be questionable in the absence of an agreed adjustment programme, because they would rest only on a baseline scenario underpinned by established policies or authorities' intentions rather than by commitments agreed with the Fund. Furthermore, the disclosure of preliminary DSAs raises important communication challenges, as the IMF needs to avoid the impression of endorsing the authorities' policy agenda or creating unwarranted ex ante expectations on the size and design of the requested programme – especially so if restructuring negotiations fail ex post.

Overall, the publication of preliminary DSAs rooted in an "uncommitted" baseline raises important conflicts between the roles that the Fund can play in an SODR, namely between its role of trusted advisor to the authorities, its role as an official creditor with fiduciary duties, as well as its policy of remaining as neutral as possible in debtor-creditor negotiations. Thus, this idea should be considered in very exceptional circumstances only, and the related pros and cons should be weighed carefully in any potential cases.

1.2 Exceptional access policy

The IMF's exceptional access policy (EAP) consists of a set of substantive criteria and procedural requirements that must be applied to all Fund-supported programmes where financing is above normal access limits; these additional criteria and procedures reflect the need for heightened scrutiny to ensure stronger safeguards for Fund resources, when the size of its programmes gets larger (see Box 1). Indeed, the containment of excessive Fund exposure and the preservation of countries' ability to repay represent key prerequisites for the IMF to play an effective role in addressing sovereign debt crises.

Box 1

The Fund's exceptional access policy: from 2002 to the present day

The set of substantive and procedural requirements of the EAP include: early Board involvement on programme discussions, assessment of certain substantive criteria, higher requirements for programme documentation, an assessment of financial risks to the Fund arising from the proposed access, an ex post evaluation within one year of the end of the programme, explicit discussions of exit strategies, and discussions of alternative forecast scenarios.

Ever since its inception in 2002-2003, the EAP has identified four "substantive criteria" to be fulfilled at programme approval and at each programme review: (1) exceptional balance of payments pressures, (2) debt sustainability (with high probability), (3) prospects of regaining market access, and (4) prospects of programme success. The framework was refined in 2009 and modified again in 2010 for ensuring the flexibility required to address the challenges posed by some euro area countries, whose debt was assessed to be "sustainable but not with high probability". One important element of the 2010 reform was the introduction of the so-called "systemic exemption" clause, which permitted the IMF to finance countries whose debt was sustainable but not with high probability, in case of a high risk of international systemic spillovers.[7]

The EAP was last reviewed in 2015 (IMF, 2015a) and formally modified in 2016 (IMF, 2016a). Importantly, the 2010 "systemic exemption" clause was abolished, to dispel fears of possible abuses when determining the existence of truly systemic risks in specific cases, and reflecting related concerns of moral hazard and overborrowing. At the same time, other forms of flexibility were considered to address cases in which debt sustainability could not be confirmed with high probability ("grey zone"), and allow Fund financing without necessarily requiring an upfront debt reduction that could bring the country back to the "green" sustainability zone.

To this effect, it was decided that Fund financing for countries in the "grey zone" would be allowed only if associated with (a) debt operations called "reprofilings", consisting of a short extension of maturities falling due during the programme, with normally no reduction in principal or coupons; and/or (b) the availability of *financing from other sources (public or private*), on a scale and terms that could help improve sustainability prospects and provide sufficient safeguards for Fund resources.

The first option rests on the idea that private creditors would be more likely to accept a debt reprofiling rather than a more intrusive debt restructuring involving nominal reductions in principal or interest ("haircuts"), if they felt that a reprofiling would be sufficient to improve (if not restore) sustainability also with the help of a Fund-supported programme. Given their less disruptive potential, debt reprofilings could effectively create some "breathing space" and address sustainability issues earlier and in a smoother way. On the other hand, it could not be categorically excluded that under extreme circumstances debt reprofilings could pose "unmanageable risks, either for domestic financial stability or in terms of possible cross-border spillovers" (IMF, 2016a).

Which option to choose (or how to combine them) was to be determined on a case-by-case basis. Generally, debt reprofilings were considered appropriate in situations where the country had lost market access, and where private claims falling due during the programme would create a significant drain on available resources. By contrast, a reprofiling would normally not be expected

[7] For an historical account of EAP developments from the mid-1990s to the euro area sovereign debt crises in 2010, see Committeri and Spadafora (2013).

for countries that could still tap international capital markets or when creditor exposure would be maintained in other ways (including through new financing).

Since its last Review in 2016, the EAP has been applied only in three cases: Argentina (SBA, 2018), Egypt (SBA, 2020), and Ecuador (EFF, 2020). Argentina and Egypt were two "grey zone" cases; however, Ecuador's debt was in the "red zone" and had to be restructured before starting the IMF-supported programme. While a comprehensive judgement of the new framework – based on only three cases – might be premature at this stage, it is nonetheless possible to flag a number of important issues that have already emerged and require careful scrutiny going forward.

First, in the case of Argentina, the assessment of the exceptional access criteria was particularly challenging, and exposed the wide scope for judgement and interpretation of IMF policy. The programme was approved in June 2018; it was substantially redesigned after only a few months (with the first review in October), and underwent three more reviews before going off-track in mid-2019. The application of the second and fourth EAP criteria (on debt sustainability and prospects of programme success, respectively) was particularly problematic; it relied heavily on staff judgement and exposed considerable room for manoeuvre in interpreting IMF policies. These margins of discretion are testified by the apparent dichotomy between an unchanged headline DSA result ("grey zone") and clearly deteriorating evidence on the development of risks throughout the four programme reviews. On the other hand, on Criterion 4 (programme success), there was awareness among the staff of the political risks surrounding the authorities' capacity to implement the agreed measures, but these risks were not sufficiently highlighted in the main reports. Another major problem with Argentina, which is indeed common to many other Fund-supported programmes, was the estimation of the country's financial needs and prospective financing from other sources during the programme. Safeguards for Fund resources were mainly postulated on the basis of an assessment – which unfortunately proved overly optimistic – about private creditors' willingness to rollover their exposure throughout the programme (see Annex A.2 for further details). **All these circumstances contributed to creating substantial and perhaps long-lasting financial and reputational risks for the Fund once the programme went off track.**

Second, no debt reprofilings have been required for exceptional access programmes since the approval of the new EAP in 2016. In the case of Argentina (2018), initially the country had not lost access to international capital markets: thus, the Fund felt comfortable with other – mostly "indirect" – financing/safeguards, through the existence of non-Fund critical mass/stock of outstanding (i.e. "restructurable") debt.[8] The same approach was followed for Egypt. In that case, the

[8] In hindsight, it is doubtful that a mere debt reprofiling would have been appropriate for Argentina, given the sheer size of its public debt as later testified by the substantial debt reduction implemented by the authorities in 2020 (see Section 4). As noted by the IMF's staff in the background documentation of the new framework, "Light restructurings have reasonable prospects for restoring sustainability at moderate levels of public debt. Light restructurings should generally not be used for high debt cases and, if they are tried and fail to work, they should not be repeated but instead should be followed by a deeper and more definitive debt reduction". See IMF (2014b), Annex II – A review of sovereign debt restructurings since the 1980s, p. 45.

staff assessed that the country could meet all the criteria for exceptional access (in particular Criterion 2), also through safeguards including the authorities having secured agreements with bilateral creditors of the Gulf Cooperation Council to rollover their deposits at the Central Bank of Egypt. Although the rollover of GCC deposits was not formally a reprofiling, its effect amounted to a partial reprofiling.[9] By contrast, reprofiling would not have been sufficient for Ecuador since the country was already in the "red zone".

Overall, experiences with debt reprofilings are typically concentrated in normal access cases, in which they were obviously not part of a "grey zone" requirement (IMF, 2014a). A prominent prior case of debt reprofiling in an exceptional access context is that of Uruguay, which successfully agreed on a face value-preserving maturity extension with its private creditors in May 2003. The reprofiling allowed the country to regain market access relatively quickly and improve economic fundamentals in a durable way (for more details on Uruguay's experience, see IMF 2014b, Box AII3, pp. 43-44). A more recent case of "normal access" reprofiling is represented by Mongolia (2017, EFF). In that case, cumulative access was 435% of quotas, the maximum allowed under normal access limits. Soon after the announcement of a staff-level agreement on the programme, the authorities went to the market and successfully exchanged maturing government bonds for a new seven-year bond with more favourable financing conditions (see IMF, Country Report No. 17/140, 2017). More recently, EMEs have voiced concerns that the IMF debt reprofiling requests can trigger downgrades in credit ratings and precipitate a full-scale restructuring – even if not initially necessary. **These potential risks notwithstanding, debt reprofilings have their own merit and deserve serious consideration going forward.**

Possible remedies to these problems are not straightforward. As a bare minimum, however, they should include (a) a more rigorous application of the exceptional access criteria, and (b) the search for firmer financing commitments from other sources and for broader burden sharing. These conditions are especially important when the uncertainty about debt sustainability is particularly elevated. In the spirit of the 2016 EAP reform, the IMF should continue to explore the circumstances under which debt reprofilings, combined with Fund-supported programmes, would be appropriate and necessary to improve debt sustainability, and ensure that countries in the EAP's "grey zone" are able to repay. In the absence of convincing arguments about the sufficiency of such reprofiling, and in the presence of significant uncertainties about the availability of financing from other creditors, a case could be made for these countries being better served by a more ambitious debt restructuring – in line with that envisaged by the EAP for "red zone" countries.

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[9] Egypt's SBA is a one-year-only programme – though with scheduled Eurobond maturities after the end of the programme, according to the IMF staff report.

1.3 Lending into arrears policies

Based on the recognition that arrears are destructive to national and international prosperity, the IMF has historically maintained a general policy of non-toleration of external payments arrears. However, this approach has evolved over the years. In particular, while the Fund still retains a policy of non-toleration of arrears to multilateral creditors, exceptions have been introduced to address situations in which a country in need of Fund financing has payment arrears vis-à-vis its private creditors (the *1989 LIA policy*) or official bilateral creditors (the *2015 LIOA policy*, previously known as "No Tolerance Policy"). See, respectively, IMF (1989) and IMF (2015b).

Both policies are subject to the fulfilment of certain general criteria. *First*, prompt financial support from the Fund must be considered essential, and the member must be pursuing appropriate policies. *Second*, the debtor should be making "good faith" efforts to reach collaborative agreement with its creditors on a contribution consistent with the parameters of the Fund-supported programme, and the failure to reach this agreement must be due to the creditors' unwillingness to provide such a contribution. *Finally*, in the case of arrears vis-à-vis official bilateral creditors, Fund lending is only permitted under the additional condition that the decision to provide financing despite the arrears would not have undue negative effects on the Fund's ability to mobilise official financing packages in future cases.

The criterion on "good faith negotiations" is the central element common to both policies. In its current formulation, the criterion rests on three broad principles to guide the dialogue between debtors and their private external creditors: (a) initiating an early dialogue with creditors, (b) timely information sharing with all creditors, and (c) allowing for creditors' input. Another important aspect of the debtor-creditor relations for LIA purposes is the **definition of a "representative" creditor committee** with which to negotiate in complex restructuring cases (see Annex A.3 for a brief presentation of the two lending into arrears policies).

The LIA policy was last reviewed in 2002; another review of that policy was considered in 2013, but was eventually postponed. An LIA review is now tentatively expected for informal Board discussion in June, and formal discussion in September 2021. This review is likely to focus on whether the policy has been applied in a consistent and effective manner, with special regard to the adherence to the good faith criterion and the role of creditor committees. **In the remainder of this section, we discuss how the LIA and LIOA policies have worked so far and draw some tentative suggestions for the way forward.**

1.3.1 How well have these policies worked?

LIA policy

The LIA policy has been applied 14 times since its last Review in 2002[10]: Argentina (2003 and 2020); Dominica (2003); Serbia (2003); Dominican Republic (2005); Iraq (2006); Cote d'Ivoire (2009); Seychelles (2009); Antigua and Barbuda (2010); St Kitts and Nevis (2011); Grenada (2015); Barbados (2018); Mozambique (2019); and Republic of Congo (2019).

Overall, the past application of the LIA policy has been uneven and has varied considerably as to the coverage of debtor-creditor relations. One aspect to consider is whether the activation of the LIA policy was explicitly specified in programme documentation. According to Diaz-Cassou et al. (2008), who examined eight selected SODR episodes in the period 1998–2005[11], this was rarely the case (neither at programme approval nor in subsequent reviews). After the 2002 review of the LIA, however, the policy was generally mentioned explicitly in programme documents, with the exception of Serbia (2003). Another (and more important) aspect to consider concerns the level of detail in the coverage of debtor-creditor relations in Fund staff reports. In 2013, Fund staff made a preliminary examination of four country cases (Dominican Republic, Grenada, Seychelles, and St Kitts and Nevis), and concluded that there were some inconsistencies in this area, with occasionally superficial assessments of the good faith criterion (IMF, 2013).

Our own review, based on ten country cases, has confirmed these findings.[12] The overall coverage of debtor-creditor relations varied considerably. In some cases, the issue was treated in a rather cursory fashion, usually with only a brief statement about ongoing negotiations with external private creditors, but without more substantiated assessments of countries' adherence to the good faith criterion and its guiding principles (e.g. Serbia, 2003; or Mozambique, 2019). In other cases, the coverage of debtor-creditor relations was more elaborated, with the provision of various details (either in the main text of the report or sometimes in dedicated boxes)[13] on all aspects of the good faith criterion: a country's early engagement, information-sharing with creditors, and seeking creditors' inputs in the process of designing the restructuring offer (e.g. St Kitts and Nevis, 2011; Grenada, 2015; and Barbados, 2018). Regrettably, in some cases staff reports were not published (or published only partially), which did not allow for a proper assessment (e.g. Dominican Republic, 2005; or Antigua and Barbuda, 2010).

The assessment of compliance with the good faith criterion was severely tested by Argentina (2003). According to Diaz-Cassou et al. (2008), the criterion

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[10] Dates in brackets indicate the start of the related relevant IMF programme.

[11] These cases include: Argentina (2001-2005), Dominican Republic (2004-2005), Ecuador (1999-2000), Pakistan (1998-2001), Russia (1998-2001), Serbia (2000-2004), Ukraine (1998-2000), and Uruguay (2004).

[12] We looked at 10 out of 14 post-2002 LIA cases mentioned above, except Iraq, Seychelles, Republic of Congo and Argentina (2020).

[13] In some cases, this was complemented by additional information included in other documents published together with the staff report in a bundle: the Memorandum of Economic and Financial Policies or statement of the IMF Executive Director representing the country in question. (Such additional information was helpful, e.g. in the cases of Côte d'Ivoire, 2009 or Dominica, 2003).

was excessively judgemental and applied in an arbitrary manner. In particular, the IMF programme was not suspended on the basis of a breach of the good faith criterion, "even if most observers believe that, rather than engaging in a constructive dialogue, the authorities simply presented a series of take or leave it offers clearly detrimental to creditors' interests". This episode was considered to be detrimental to the LIA policy's credibility, and cast doubts on the enforceability of the good faith criterion (see also Bedford and Irwin, 2008). **Argentina's case also stood out in our own review.** Among the ten cases under consideration, only in Argentina had IMF staff already identified the good faith aspect of the authorities' restructuring strategy as being among the major risks to the programme at the time of its request. Nevertheless, based on the initial steps taken (a series of meetings with creditors, formation of consultative groups) and subsequent commitments by the authorities to constructive negotiations, the programme and its first two reviews were approved. This was done despite the fact that extended discussions on LIA-related topics were explicitly cited as the main reason for the delay of the first review. In the end, however, the authorities presented a non-negotiated offer to the creditors, while no further programme review took place, thereby confirming the initial doubts.

Creditor committees were not always a part of the restructuring, and the Argentine case raised the question of whether LIA's requirements remain appropriate in light of the increased complexity of the creditor base. In half of the cases considered, formation of creditor committee(s) was not reported. In Serbia (2003) and Côte d'Ivoire (2009) the London Club played a major role. Grenada's (2015) case positively stood out with a creditor committee representing 76% of the total outstanding bonds subject to restructuring – a rare case above the 75% threshold needed for the activation of collective action clauses (CACs). IMF (2013) noted that the formation of representative creditor committees may prove increasingly difficult due to the growing complexity of the creditor base in some cases, characterised by heterogeneous bondholders with different interests, investment horizons and accounting rules (e.g. book value vs. marking to market). This has made it even more complicated to gauge the good faith criterion. Most prominently, in the case of Argentina's restructuring of 2004/2005 there were more than 30 creditor committees. At that time, the IMF considered that the Global Committee of Argentina Bondholders (GCAB), accounting for about one-half of Argentina's external private debt, was representative for LIA purposes. However, the Argentine authorities did not share this assessment and were not willing to engage with GCAB as a major negotiating partner. In the end, no constructive dialogue was undertaken, and the case prompted the Fund to further reflect on such complex cases – which is also expected to be reflected in the upcoming LIA review.

LIOA policy

Since the 2015 review, there have been only a few cases of official claims restructurings under the umbrella of the LIOA policy. In particular, restructurings of official loans in the context of discussions about a Fund-financed adjustment programme (including programme reviews) have fallen into three categories:

- *Cases in which the sovereign debtor could reach a restructuring agreement with a representative group of Paris Club creditors*. In these cases, remaining

arrears to non-participating creditors were “deemed away” based on the Club’s comparable treatment principle (see Annex A.4); the staff reports usually only include a reference in a footnote saying that the debtor’s best efforts continue with non-participating official creditors. There have been 11 cases of this type since 2015.

- *Cases in which the sovereign debtor could not reach a restructuring agreement with a representative group of Paris Club creditors, but official bilateral creditors expressed their consent to Fund lending* (usually through the representing Executive Directors). Since the 2015 review, there have been eight SODR cases with official creditor consent, involving six debtor countries.

- *Cases in which the sovereign debtor could not reach a restructuring agreement with a representative group of Paris Club creditors, and at least one bilateral creditor did not express consent to Fund lending*. In these cases, the LIOA applies and Fund lending is allowed on the basis of meeting the three general criteria of the LIOA policy (i.e. critical importance of Fund support, good faith negotiations, and the Fund’s ability to mobilise official financing packages in future cases).

Since the 2015 review, there have been **seven debt restructuring cases** without creditor consent that triggered the application of the LIOA, involving four debtor countries and three non-consenting creditor countries (Central African Republic and Grenada vs. Libya, The Gambia vs. Venezuela and Ukraine vs. Russia). In these cases, the IMF Report has included an annex to extensively discuss the application of the LIOA, namely the staff’s assessment of whether the three criteria above have been met.

- On the first criterion, staff have generally substantiated the case that prompt Fund financial support is essential to address strong balance of payments’ pressures that result in large external and fiscal financing gaps. In particular, Fund financing was deemed to be instrumental in: maintaining an adequate level of reserves and avoiding a deeper recession (Ukraine); anchoring macroeconomic stability, achieving debt sustainability and catalysing international financial support (The Gambia); bolstering government spending to contain the COVID-19 pandemic and supporting the economy (Grenada); strengthening macroeconomic stability and external viability through fiscal and structural reforms while catalysing external support (Central African Republic). In all cases, staff also underscored that the country was pursuing appropriate policies.

- The case of Grenada stood out, as the DSA suggested that Grenada’s public debt was sustainable and on a downward path, however, the country was classified as “in debt distress” solely because of unresolved arrears to official bilateral creditors (of some 1.8% of GDP), as per the rules of the Debt Sustainability Framework for LICs (see Section 1.1).

- On the second criterion, staff reports focused on both the process – stating that the country was reaching out to the creditor to negotiate in good faith and to

resolve the outstanding arrears in a collaborative way – and the terms; assessing whether they were in line with the financing and debt objectives of the Fund-supported programme.

- On the third criterion, in all cases staff concluded that the decision to provide financing despite the arrears, was not expected to have an undue negative effect on the Fund's ability to mobilise official financing packages in future cases.

Overall, it seems fair to conclude that the 2015 LIOA has worked reasonably well so far. The application of the policy has been adequately motivated by the staff, and the policy has been effective in preventing individual official creditors from imposing an undue veto on Fund financing.

1.3.2 The way forward

Good faith – **The good faith criterion can be difficult to assess in practice, but no convincing alternative to it appears to exist.** On the one hand, any attempts to operationalise it further through the introduction of additional specifications may prove elusive and may contradict the very necessity of striking a reasonable balance between clarity and flexibility. On the other hand, some observers have criticised the inherent vagueness of the good faith criterion and expressed the concern that private creditors could lobby the IMF to withhold funds because of alleged "bad faith" behaviour of the debtor (Buchheit and Lastra, 2007). Other critics have proposed to replace the good faith criterion with price incentives (interest surcharges on the cost of LIA programmes) to encourage defaulting countries to promptly and constructively negotiate with their private creditors (Bedford and Irwin, 2008). However, these surcharges would not only add to the debt burden of the country, but may also be difficult to legitimise when private creditors are being asked to absorb substantial losses in order to restore a country's debt sustainability. In addition, adding a surcharge in a distressed context may increase the risk of a default on multilateral obligations, thereby posing a potential challenge to the Fund's preferred creditor status (Diaz-Cassou et al., 2008).

On balance, the good faith criterion should be retained, but there is scope to enhance the transparency of its application. The collaborative, good-faith approach to resolving arrears, as required by the LIA policy, remains the desirable course of debtors' action, and the most promising way to regain access to international capital markets after a default and help limit litigation. Conversely, the debtor's uncooperative or "bad faith" behaviour (e.g. non-negotiated "take-it-or-leave-it" offers) may lead to contentious litigation and suboptimal outcomes, so IMF lending in such situations would not only increase the risks to its own resources, but also undermine the goal of achieving efficient and orderly restructurings.

At the same time, to ensure more systematic coverage of debtor-creditor relations in staff reports, **the Fund could delineate a more detailed and predictable standard to describe the three dimensions of the good faith criterion** (early dialogue, timely sharing of relevant information, and opportunity for creditors' input), and

endeavour to use this standard on a regular basis in the documentation prepared for LIA cases.

Moreover, the "information sharing" dimension of the good faith criterion may provide a convenient means to support the international community's efforts to enhance debt transparency (see Section 2). In particular, the IMF could clarify that sovereign debtors, acting in good faith, are expected to provide a comprehensive picture of the planned treatment of their domestic and external debts, including those vis-à-vis official bilateral creditors. Public disclosure of this information would create indirect pressures towards greater inter-creditor equity, without violating the presumption that the IMF should not interfere in restructuring negotiations. This aspect should receive due attention in the upcoming review, possibly also in the pre-default context (see below), given the current strong focus of international debates on enhancing debt transparency.

Creditor committees – **The growing complexity of the creditor base may have made it more challenging to form a representative creditor committee, but the expectation of a dialogue with one (or a small number of) representative committee(s) remains sensible, as demonstrated** (although outside of an IMF programme**) by Argentina's recent debt restructuring in 2020.** On the one hand, committees can contribute to a higher creditor participation rate, as their endorsement of the restructuring proposal signals broad acceptability to other creditors. On the other hand, setting up a committee and reaching an internal agreement may be time-consuming and potentially further complicated by any changes in its composition due to secondary market trading. The IIF Special Committee on Financial Crisis Prevention and Resolution (2014) expressed strong views against the abandonment of the requirement for good-faith negotiations with representative creditor committees. It found the IMF's doubts related to the increasing diversity of bond investors as unjustified – on the contrary, it saw the diversity of bondholders as an advantage, adding depth and liquidity to sovereign bond markets.

Creditors not represented in the Paris Club – **One important aspect of the growing complexity of the creditor base concerns the rise of new creditors represented by profit-seeking corporations fully owned or controlled by governments that do not take part in (or are not full members of) the Paris Club – e.g. the China Development Bank and the Export-Import Bank of China.** The claims of these emerging creditors have grown rapidly over the last decade (see Horn et al., 2019), but a comprehensive picture of the precise amounts and lending terms is still missing due to lack of data. While the stock of Chinese lending remains sizeable following years of rapid growth, there is some early evidence that the flows of new loans have significantly slowed down since 2017.[14] . Importantly, there is more than simply anecdotal evidence to suggest that in some restructuring deals these lenders had enough bargaining power to receive more favourable terms than Paris Club creditors (Gardner et al., 2020) – thanks also to the terms and conditions included in some of their loan contracts (Gelpern et al., 2021). From the point of view of the Fund's LIA policies, these creditors raise two main issues. First, in connection with the

[14] As recently reported by the Institute of International Finance; see IIF, Weekly Insight, 07.01.2021.

applicability of the good faith criterion, it would be important to clarify whether the presence of “dominant” foreign creditors that can negotiate their own deal at patently more favourable terms than the other creditors would represent a circumstance hindering Fund financing or not. Second, it is necessary to clarify the status of their claims (official vs. private), and determine whether these entities should be subsumed under the LIA or LIOA policies in case of Fund-supported programmes.[15]

IMF stance on debtor-creditor engagement in a pre-default context – **In the LIA context, one may wonder whether there is a need to formalise the IMF’s practice on debtor-creditor engagement in pre-default situations. This idea, however, seems to be rather problematic and it is unlikely it will be put into practice any time soon.** The broadly positive experience of the recent restructuring of Argentina’s debt would seem to suggest that this is not a priority. There is no formalised policy in a pre-default context and outside of the LIA policy, and the IMF does not insist on any particular form of debtor-creditor dialogue in these cases (e.g. even if a representative creditor committee is formed, the good faith criterion does not apply). As a general approach, the IMF encourages the member to stay current on its obligations and engage in discussions with creditors (as, for example, in the case of Dominica, 2003). Pre-default (pre-emptive) restructurings are generally preferable, as they tend to be less disruptive, and help to re-establish market access more quickly (Asonuma and Trebesch, 2016). However, if a country requires IMF financial support in pre-default situations, one essential prerequisite to provide Fund financing is that a credible restructuring process (leading to sufficiently high creditor participation and closing the programme financing envelope, as well as restoring debt sustainability with high probability) should be underway.[16] However, in pre-default restructurings coordination problems may become more acute, as creditors know that in such situations speed is of the essence for the debtor – which gives them greater leverage on the debtor that wants to avoid a default. In 2013, the IMF suggested that it could consider setting a clearer expectation that non-negotiated offers by the debtor (following informal consultations with creditors) rather than negotiated deals, would be more effective in pre-default cases given the time constraints (IMF, 2013; see also IMF, 2015a). On the other hand, the idea of such non-negotiated, unilateral deals was seen as “highly problematic” by the IIF Special Committee on Financial Crisis Prevention and Resolution (2014), as it could undermine creditor property rights and market confidence and thus raise secondary bond market premiums for the debtor involved and other debtors in similar circumstances.

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[15] Private sector involvement has proven contentious in implementing the G20-Paris Club Debt Service Suspension Initiative (DSSI). It is likely to be also controversial for debt treatments under the G20-Paris Club Common Framework, which are predicated under the comparable treatment principle; see Section 3.

[16] This could include hiring of legal and financial advisors by the debtor, and creditor engagement in relation to the debt strategy.

2 The Fund’s role in supporting debt transparency

Ever since the Asian crises of the late 1990s, the international community has made substantial efforts to enhance debt transparency, as a means to foster greater discipline and mitigate the problems of asymmetric information affecting sovereign debt markets. Greater availability and disclosure of timely, harmonised, and appropriately granular information on countries’ debt can offer substantial benefits for the debtor, for its private and official creditors, and more generally for the prevention and management of sovereign debt crises.

In particular, enhanced transparency would help: the IMF – to make accurate DSAs with a more realistic vision of the risks around central scenarios, and to better gauge risks related to the rollover of other creditors’ claims during Fund-supported programmes; **sovereign debtors** – to devise more effective debt management strategies; to better monitor their public finances over time; to strengthen their accountability vis-à-vis parliaments, domestic taxpayers and foreign creditors; and to formulate restructuring offers when a SODR becomes unavoidable. In addition, enhanced transparency would spare sovereign borrowers the dire consequences of “hidden debt surprises”[17], and could foster investors’ trust in the longer term – leading to lower financing costs (Kemoe and Zhan, 2018); **the creditors** – to take more sustainable investment decisions, to increase their own accountability to their own regulatory and supervisory authorities, and to compare their treatment with the one received by other creditors in a debt restructuring; and **other market participants** (including rating agencies) – to better identify emerging risks and assess sovereign creditworthiness.

Recent international efforts on debt transparency fall on two related and mutually supporting fronts. These efforts aim, respectively, at: (a) improving countries’ ability to deliver transparency, through the provision of technical assistance aimed at developing more effective systems for collecting, processing, and managing debt information; and (b) promoting greater disclosure of debt information worldwide, and facilitating its use in the prevention and management/resolution of sovereign debt crises.

Initiatives in the first area are targeted at debtor countries[18]; those in the second area also contemplate an active involvement of creditors and their associations, reflecting the idea that debt transparency can only be achieved through a coordinated effort of international organisations, sovereign debtors, official creditors, and the private sector. The principal initiatives in this latter area

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[17] Such as the sovereign debt crisis experienced by Mozambique in 2016. See the Box “Mozambique. A case of hidden debt” in IMF and World Bank (2018), p. 17. Although less frequently than in low-income and lower-middle-income countries, cases of sovereign debt misreporting have occasionally also affected advanced countries (e.g. Greece in 2009), with no less unsettling ramifications.

[18] For a synthetic account of the international division of labour in the field of technical assistance, see IMF and World Bank (2018), pp. 18-21.

hinge, respectively, on the *G20 Operational Guidelines for Sustainable Financing* (the "G20 Guidelines", for official creditors; see Group of Twenty, 2017) and the *Voluntary Principles for Debt Transparency* of the Institute of International Finance (the "IIF Principles", for private creditors; IIF, 2019).

Both the G20 Guidelines and the IIF Principles rely on the voluntary cooperation of their members. In particular, G20 countries have committed, inter alia, to: share relevant information for DSA purposes, make public information on past debt restructurings from official and private creditors, ensure that commercial creditors adequately contribute to debt relief when required, and provide the necessary technical assistance to debtor countries. The IIF Principles are designed to complement the G20 Guidelines on the private sector's side, with the disclosure of granular data and metadata on financial loans to sovereigns, sub-sovereigns and public corporations of PRGT countries. The OECD has volunteered to act as a repository for the data provided by IIF members. **These initiatives are still in an early implementation stage, and will take time to bear fruit.**[19]

The IMF can play an important role in both areas. First, it contributes to developing internationally accepted standards for public debt statistics, in close cooperation with other international organisations. Second, it provides technical assistance services on fiscal matters to its members, also in cooperation with the World Bank. Third, it maintains large and detailed multi-country databases, which are mostly accessible to the public, and complement those maintained by other institutions such as the World Bank, the BIS, and OECD.[20] Fourth, the Fund (together with the World Bank) assists the G20 in monitoring the implementation of its Operational Guidelines (see IMF and World Bank, 2019).

More importantly, the IMF can request appropriately granular debt information to its members, by virtue of the authority granted through its lending and surveillance duties. Article VIII, Section 5 sets out a comprehensive legal framework for the reporting of information by Fund members (Leckow, 2005). The obligation to report applies to all members, and concerns information required for the purposes of any of the IMF's activities, including surveillance and financial assistance. The provision sets out a minimal list of information to be reported, but empowers the IMF's Executive Board to require additional information if this is necessary for the activities of the Fund. On the other hand, the IMF has an obligation to keep confidential any information reported by its members and cannot publish it without their consent.

In a lending context, the Fund can always request, on a case-by-case basis, specific debt information as a condition for the provision of financing, if this is essential for programme design and ultimately the safety of Fund resources. This might be particularly necessary in case of existence of complex debt

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[19] Another proposal to enhance debt disclosure was suggested in 2020 by a G30 working group (G30, 2020). The proposal rests on a "normative" basis and consists in establishing a platform for disclosing public debt contracts, underpinned by authorisation procedures that make these contracts enforceable in courts only if their details are published on the platform.

[20] A brief description of internationally available databases can be found in IMF and World Bank (2020), Annex, Table 2, pp. 23-24.

instruments, including collateralised sovereign debt, which have a bearing on the "pecking order" of claims. In such cases, the Fund can also set explicit conditionality to limit or reduce such contractual arrangements, as occurred with the Extended Fund Facility for Angola in 2018. In that case, prior actions on fiscal conditionality included the provision of detailed information on: the collateralised debt of the central government and the state-owned oil company, "Sonangol"; the provision of detailed information on recorded public guarantees; and the request to provide information on possibly unrecorded public guarantees. Importantly, the programme prohibited the contracting of new collateralised debt as a performance criterion.[21]

More recently, the Fund has approved a revised version of its Debt Limits Policy that prescribes the systematic inclusion, in the documentation of all IMF-supported arrangements, of a table containing detailed information on the holders of a country's external and domestic public debt (IMF, 2020c, p. 38). In addition, as noted earlier in Section 1.3, the application of LIA/LIOA good faith criterion could be strengthened to require public disclosure of granular information about the treatment of domestic and foreign creditors in a debt restructuring.

The upcoming Review of Data Provision to the Fund for Surveillance Purposes in 2021 will offer another opportunity to broaden the minimum data provision obligations on public debt. These obligations are currently limited to the stock of central government and central government-guaranteed debt, and its composition by currency, maturity, and residency of the holder. With the Review, reporting obligations could include data on general government debt and information by instruments, including on collateralised debt.

At the same time, the IMF is also interested in using the additional information made available by other institutions for conducting its own surveillance and lending activities. To this end, the Fund should collaborate closely with the OECD and IIF on the ongoing repository initiative for private creditors' claims – to better understand the data collected through this initiative, and ensure they could actually be used for its lending and surveillance activities.

[21] Disclosure of fiscal information as a precondition of official lending is also contemplated in the practice of other International Financial Institutions such as the World Bank. In particular, the Sustainable Development Finance Policy (SDFP) of the World Bank provides a blueprint for a systematic financing-related lever to improve debt transparency. Each year countries with elevated debt risks are assigned performance and policy actions (PPAs) that are key to enhancing debt transparency, fiscal sustainability, and debt management. Countries that do not satisfactorily implement their PPAs will not be able to access 10% or 20% of their IDA country allocations in the following year, depending on their level of risk of debt distress.

3 The role of the IMF in the institutional setting of the sovereign debt restructuring architecture

After the demise of the IMF's Sovereign Debt Restructuring Mechanism (SDRM) proposal in 2002, the quest for firmer institutional underpinnings of a sovereign debt architecture has not produced practical results[22], but the need for suitable venues for debtor-creditor dialogue has remained strong. As noted in the introduction, one of the key purposes of the Fund is to provide the machinery for consultation and collaboration on international monetary and financial issues. To this end, the IMF can engage with private and official stakeholders, leveraging its own expertise to facilitate debtor/creditor dialogue and orderly SODR processes.

The current SODR architecture rests on a relatively rigid separation between the claims of private and official creditors. The restructuring of sovereign debt owed to *private creditors* is typically implemented through market-led processes: restructurings are activated by the debtor, but their outcome crucially depends on the creditors, taking into account the legal and financial features of sovereign debt contracts, which are determined by the market practices and legal standards prevailing in major financial jurisdictions. The restructuring of official claims is arranged differently, reflecting the specific creditor status of the institutions involved. Multilateral claims – particularly those of the IMF – stand at the top of the hierarchy and as a rule are not subject to any restructuring.[23] Bilateral claims are mostly treated via the Paris Club; they have a lower seniority than multilateral claims but should generally be senior to private claims. Regional financing arrangements (RFAs) acknowledge the IMF's seniority and cooperate informally including by providing financial assurances to Fund-supported programmes (IMF, 2017b), but the restructuring of their own claims is largely detached from similar debt operations with other creditors, reflecting their regional mandates and specific governance arrangements.

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[22] In the mid-2010s, there were a few proposals in this direction approved by the UN General Assembly, which nonetheless amounted to statements of principle without any concrete follow up. In September 2014, the G77 and China successfully passed a resolution to elaborate and eventually adopt a "multilateral legal framework for sovereign debt restructuring processes"; the preparatory work for establishing this framework was tasked to an ad hoc committee created in December 2014. In September 2015, a third UNGA resolution put forward nine (non-binding) "basic principles": a sovereign's right to restructure its debt, good faith, transparency, impartiality, equitable treatment of creditors, sovereign immunity, legitimacy, sustainability, and majority restructuring.

[23] If a country is unable to repay the Fund, it can either try to get new external financing to meet its obligations vis-à-vis the Fund, including by requesting a new IMF loan arrangement if this is consistent with the Fund's lending policies, or fall into arrears and become subject to the Fund's strategy on the overdue financial obligations of its members. This strategy contemplates remedial measures that inter alia include, for the most problematic cases, the suspension of voting/representation rights and compulsory withdrawal from the Fund. This said, the IMF has always preferred to follow a collaborative approach with members in protracted arrears; on extremely rare occasions, it has helped these members to clear their arrears by mobilising financing from other donors (e.g. in the case of Liberia in 2008; see IMF, 2018b, Box 3.10, p. 75).

Recent developments in the international financial landscape have affected the pillars of this architecture in several ways. On the one hand, the growing importance of new official and quasi-official bilateral lenders not represented in the Paris Club has blurred the dividing line between private and official claims, and has challenged the smooth functioning of well-established processes for the restructuring of official bilateral claims. On the other hand, the increasing diversity of financial instruments involved in sovereign borrowing by developing countries (particularly through the rapid diffusion of opaque and non-standardised sovereign debt contracts) has undermined the ability to achieve a reasonable degree of inter-creditor equity in concrete restructuring cases, with apparent repercussions for both private and official creditors. All such developments have increased the need to find appropriate means to ensure a more holistic and inclusive participation of all creditors involved in SODR processes. A most notable effort in this area is the "Common Framework for Debt Treatments", agreed by the Group of Twenty in November 2020 (the G20 Common Framework hereafter; see Group of Twenty, 2020b). *This section focuses on the IMF's interactions with the Paris Club and the G20 Common Framework.*

The Paris Club has a symbiotic relation with the IMF, which rests on a mutually beneficial exchange. On the one hand, it underpins Fund-supported programmes with assurances about the financial support granted by official bilateral creditors. On the other hand, the IMF participates in the Paris Club meetings, and through Fund-supported programmes Paris Club creditors are reassured that the debtor country has committed to sound policies to return to a sustainable path. In this way, the IMF helps these creditors to determine the amount and features of the relief needed to restore debt sustainability that is offered to the debtor.[24]

At the same time, the IMF never interferes directly in the negotiations for restructuring sovereign debt owed to other creditors (private and official), and therefore it is not feasible for the Fund to directly help Paris Club creditors to enforce their "comparable treatment" principle (i.e. that the relief granted by other official or private creditors is equivalent to that of the Paris Club). "Comparability of treatment" is an important objective from the point of view of Paris Club creditors, because it aims at ensuring that the claims of their respective taxpayers are not subordinated to the claims of other creditors and that their financial interests are preserved. To this effect, official debt relief granted in the Paris Club entails an obligation of the beneficiary country to seek comparable debt treatments from both its private and non-Paris Club official creditors (see Annex A.4 for further details).

Comparable treatment is an obligation for the debtor country, but the Paris Club has no legal means to enforce this obligation. One indirect means to incentivise comparable treatment is represented by its prevalent practice of offering "flow-based" debt relief instead of upfront write-offs (i.e. changes in the profile of debt service repayments that leave nominal debt unaffected but reduce its present value),

[24] Paris Club creditors provide debt treatments on a case-by-case basis, either in the form of rescheduling/reprofiling, which is debt relief by postponement of debt service obligations or, in the case of concessional rescheduling, reduction in debt service obligations during a defined period (flow treatment) or as of a set date (stock treatment).

which facilitates the possibility of reversing the relief if the comparability of treatment is ultimately violated. As is evident, however, the credibility of this threat is directly related to the relative importance of Paris Club claims vis-à-vis those of the remaining creditors.

Since the share of Paris Club creditors in the external debt of low-income countries has been decreasing in recent years[25], it seems plausible to conclude that *the enforcement of comparable treatment has become more important and, at the same time, more challenging*, due to the lack of appropriate incentives and levers. **This has reinforced the case for broadening Paris Club membership, by inviting major "emerging" lenders such as China and India to participate in its meetings on a more regular basis.**[26]

More generally, **the Paris Club's operational modalities offer an expedient and flexible blueprint for a more inclusive venue for creditor coordination and debtor-creditor dialogue.** The COVID-19 crisis has further highlighted the need for institutional evolution and enhanced cooperation at all levels, with a central role for the IMF. The liquidity treatment by official bilateral creditors under the G20's Debt Service Suspension Initiative (DSSI), to temporarily defer the debt service of eligible LICs while leaving unaltered the present value of their claims (Group of Twenty, 2020a, pp. 14-15), has helped these countries to improve their liquidity conditions; however, private sector participation has been absent.[27] The severity of debt problems in several DSSI-eligible countries has naturally required the need to move from addressing liquidity problems to treating solvency problems, including by resorting to traditional Paris Club tools in order to ensure burden sharing by private creditors via the comparability of treatment clause.

The G20 Common Framework is an important milestone, as it brings together Paris Club and non-Paris Club official creditors in a coordinated process to deliver jointly on debt treatments for eligible countries, on a case-by-case basis. The expected reliance on Paris Club procedures and principles under the Common Framework would also reaffirm the central role of the IMF in sovereign debt restructuring. Indeed, the need for any debt treatment and the size of the required restructuring envelope are to be based primarily on a joint IMF-World Bank DSA and will have to be consistent with the parameters of an (obligatory) upper credit tranche (UCT) IMF-supported programme. As is the case in regular Paris Club meetings,

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[25] According to World Bank data, the share of Paris Club creditors in the official bilateral public and publicly guaranteed (PPG) external debt of DSSI-eligible countries has fallen from 85% in 2004 to 27% in 2019. As official bilateral debt accounts for 34% of 2019 total PPG external debt (41% in 2004) of the same group of countries, the share of Paris Club creditors in total PPG external debt currently stands at 9% (34% in 2004). The drop in the share of Paris club creditors has been largely offset by the rapid increase of China, which in 2019 accounted for 57% of DSSI-eligible countries' PPG external debt owed to bilateral creditors (from 3% in 2004). During the same period, the share of private creditors has increased from 7% to 19%, while multilateral debt has declined from 52% to 46% of total PPG external debt.

[26] China, India, Turkey and several other emerging countries currently participate in Paris Club meetings on an ad hoc basis. They are invited in relation to a signalled interest in specific countries and issues. Ad hoc participants are eligible – but not required – to participate in any given debt workout (for more details, see the Paris Club's website).

[27] The debt service suspension promoted by G20 countries is formally equivalent to a "debt reprofiling" in the Fund's terminology (see Section 1.2), but without an IMF programme. Most DSSI-eligible countries have been reluctant to request private creditor participation in the first place, due to fears of the negative impact this would have on their (hard-won) market access and broader reputation.

under the Common Framework the IMF – together with the World Bank – is expected to brief creditors about the debtor's macroeconomic situation and about the progress in implementing the debt treatment. The Framework will be managed on a case-by-case basis, but the experience with its first few debt treatments is likely to provide important indications about its operational modalities.

One problem to address is how to properly communicate the participation of debtor countries in the Common Framework. Three countries that in 2020 benefited from the suspension of debt service payments under the DSSI (Chad, Ethiopia, and Zambia) have recently applied for debt treatment under the Common Framework. In the case of Ethiopia, the anticipated involvement of private creditors in debt restructurings, entailed by the comparability of treatment principle endorsed by the Common Framework, had an immediate repercussion on the country's credit rating.[28]

The IMF can contribute to ease other challenges raised by the Common Framework. First, similarly to the Paris Club, the Common Framework seems to feature an *apparent bias against granting debt treatments in the form of debt write-offs or cancellations.* When these treatments would be necessary, the Common Framework recognises that "specific consideration will be given to the fact that each participating creditor shall fulfil its domestic approval procedures in a timely manner while keeping other creditors informed of progress" (Group of Twenty, 2020b, p. 2). Through DSAs linked to its programmes, the IMF can help avoid that the debtor and creditors involved in Common Framework negotiations agree to a debt treatment that delivers neither too much nor too little relief for a robust return to sustainability.

Second, *comparability of treatment may be more difficult to achieve than in the past, given debtors' increasingly complex debt structure in terms of both creditor and debt instrument composition*. Maximum information sharing between debtors and creditors, and among creditors will be a necessary first step. As already noted in Section 2, the IMF has a critical role to play in promoting the disclosure and quality of all relevant debt data – including information on collateralisation, PPPs, and guarantees – through its work programme on debt transparency (jointly with the World Bank) as well through programme conditionality. One should be very cautious about the Common Framework's carve-out in debtor reporting obligations for "commercially sensitive information" (Group of Twenty, 2020b, p. 2). In any restructuring, undisclosed debt should be expected to be subordinated in terms of recovery value relative to disclosed debt.

Finally, even if the responsibility of seeking debt treatments on comparable terms from other official bilateral creditors and private creditors ultimately lies with the debtor country*, the IMF could facilitate the dialogue between the debtor and the other creditors not participating in the Common Framework*, without getting involved in actual negotiations or micro-managing the process. To this end, the IMF could: (a) clarify the debtor country's debt and broader macroeconomic situation to creditors (through its surveillance or informal meetings), (b) reconcile debt data obtained from

[28] Fitch downgraded Ethiopia by two notches (to CCC) after the announcement by the government of its intention to join the Common Framework. Zambia was already in "selective default" (following a missed coupon payment on a Eurobond issue last October), while Chad is not rated.

debtors and creditors, (c) work out a strong and credible reform programme together with the debtor, (d) advise debtors to recognise when debt is unsustainable and creditors to make themselves known in case of debt problems, and (e) monitor whether negotiations between debtors and creditors take place “in good faith” (as part of its lending into arrears policies).

4 The Fund's role in promoting contractual standards and monitoring legislative developments

As noted earlier, the restructuring of sovereign debt owed to external private creditors[29] is typically implemented through market-led processes determined by the market practices and legal standards prevailing in major financial jurisdictions. These standards can be particularly important to shape the participation of private creditors and overcome the "holdout" problem that afflicted – if not disrupted – many restructurings in the past: this is a key aspect of orderly SODR processes, of utmost interest from the IMF's point of view. This participation has become all the more relevant in the current debt landscape, which is more complex and diverse than it has ever been before.

Although the IMF is not an international standard-setter, it has acted as a promoter of international contractual standards for sovereign bonds in light of the role that these standards may play for an orderly resolution of sovereign debt issues. Against this backdrop, the IMF has since October 2014 endorsed the use of "enhanced" Collective Action Clauses (CACs)[30] in international sovereign bond contracts. These are standardised clauses (developed by the International Capital Markets Association (ICMA)) and represent the "third generation" of CACs. The main novelty in this generation is that they include a flexible menu of voting options, among them a so-called "single limb" voting procedure that should further minimise holdout behaviour (relative to "series-by-series" or "two-limb" voting rules).[31]

The IMF has also been engaged in the study of other forms of contractual standards and of legislative initiatives with more "statutory" elements, in particular: (a) the so-called "state contingent debt instruments" – as a means to improve debt sustainability prospects in the face of adverse shocks; and (b) "anti-vulture fund" legislation aimed at discouraging holdout behaviour via a reduction in the related expected profits.

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[29] This section deals explicitly with the restructuring of international sovereign bond contracts (i.e. debt issued under foreign jurisdictions). Euro area countries are in a unique situation, since the ESM Treaty has prescribed to include, starting from 2013, standardised CACs for all new euro area government debt securities with a maturity above one year, both domestic and foreign law-governed securities.

[30] A CAC is a provision in a bond contract that "allows a majority of creditors either within – or across – series of bonds to bind the minority to the terms of the restructuring. These provisions limit the risk that a minority of creditors will disrupt an orderly restructuring process by 'holding out' – or threatening to hold out – in order to receive payment in full at the expense of the restructured majority" (IMF, 2020b, p. 22). The IMF has a long tradition of promoting better design and use of CACs (following the failure to launch the statutory SDRM in the early 2000s), and these efforts have been supported by its Executive Board.

[31] A two-limb voting procedure requires that a minimum threshold of support be achieved both in each bond series and across all series subject to the restructuring offer. Conversely, a single-limb voting procedure requires only a single vote calculated on an aggregated basis across all affected bond series. The IMF has clearly expressed a preference for the latter model, which seems to offer the best protection against holdout creditors obtaining blocking positions on particular bond series.

This section briefly touches on: (1) the uptake of enhanced CACs since 2014; (2) recent experiences of sovereign debt restructurings with CACs (Ecuador and Argentina, 2020); and (3) some concrete reform options. Two additional issues are also discussed, which deserve further scrutiny in a longer time perspective. These are: (4) the pros and cons of possible state-contingent debt instruments; and (5) the perspectives for a broader adoption and use of anti-vulture legislation.

4.1 Uptake of enhanced CACs

Since the IMF's endorsement of enhanced CACs, the uptake has been very good. In a recent update, the IMF reports that, between October 2014 and end-June 2020, 91 percent of all 690 new international sovereign bond issuances included the enhanced CACs (IMF, 2020b). In terms of the stock of international sovereign bonds, this implies that about half of it now includes enhanced CACs. It will take some time before the bonds without enhanced CACs mature. Whereas uptake has been high in bonds issued under English and New York law (representing the bulk of the outstanding stock), enhanced CACs have not been included in other jurisdictions, notably bonds issued under Japanese or Chinese law.

Empirical studies have focused on the ex ante effects of CAC inclusion on sovereign bond prices and found that bonds including (newer) CACs had similar or lower yields than bonds without such CACs (rather than higher yields, as some had feared). However, more research is needed on the ex post effects of CACs on the debt restructuring process.[32] While CACs may be useful in achieving broad creditor participation, they are no panacea and cannot substitute for constructive engagement between the debtor and its creditors.[33]

4.2 Recent experiences with CACs: Ecuador and Argentina (2020)

While there have not yet been any real-life experiences with debt restructuring under enhanced CACs with single-limb voting, the recent restructurings in Argentina and Ecuador provided the first real test cases for the use of enhanced CACs with two-limb voting in international bonds.[34] The bottom line seems cautiously positive and promising. Over 98% of creditors consented to the Ecuador debt exchange, resulting

[32] On price effects, see Bardozetti and Dottori (2014), Bradley and Gulati (2014), Picarelli et al. (2019), Grosse Steffen et al. (2019), Carletti et al. (2021), and Chung and Papaioannou (2020). A notable study by Fang et al. (2021) finds that CACs do help to reduce holdout rates, especially for bonds with high haircuts. Their simulations show that only single-limb CACs minimize the holdout problem.

[33] As Gelpern and Zettelmeyer (2020) put it, CACs may well be like doorknobs: useful, but perhaps not essential. "When a house is on fire, well-functioning doors—and doorknobs—could save lives. However, keeping doorknobs in good working order does not amount to a fire prevention strategy, or even an emergency management plan" (pp. 113-114).

[34] Argentina and Ecuador's choice for the two-limb voting procedure was informed by the "uniformly applicable" provision (requiring the debtor to offer holders of all affected bond series the same exchange terms or menu of exchange options) that comes with single-limb voting. This provision was difficult to fulfil due to the diversity of bonds and creditors involved in the restructuring and because of domestic law constraints (see De la Cruz and Lagos, 2021).

in 100% participation after the use of CACs. Over 93% of creditors consented to the Argentinian exchange, resulting in over 99% participation. That notwithstanding, the restructurings brought to light certain loopholes in the design of enhanced CACs supported by ICMA. Specifically, the so-called "redesignation" and "PAC-man" (legal) strategies adopted by Argentina demonstrated that contractual shortcomings could be exploited by debtors who are unwilling or unable to build the requisite consensus with their private creditors (Clark and Lyratzakis, 2021). In these recent cases, sovereign bonds with single-limb and two-limb voting structures coexisted, and the sovereign had to factor this circumstance in – considering how to offer the holders of all affected bond series the same exchange terms or menu of exchange options as envisaged by a single-limb structure. In other terms, the complexity of the solution adopted by the authorities was dictated by the heterogeneity of contractual standards in the eligible sovereign bonds.

Box 2
Redesignation and "PAC-man" strategies

Redesignation consists in excluding particular bond series from the voting pool under a two-limb procedure after the votes have been counted, allowing debtors to "gerrymander" ideal voting pools to maximise the cram down of holdout creditors (IMF, 2020b). Of course, if bondholders do not have full transparency as to how their votes will ultimately be counted, this raises concerns of fairness.

The "PAC-man" concept boils down to a strategy, whereby the debtor restructures a selection of bonds with the support of less than an overall supermajority of bondholders and then proceeds to aggregate (using single-limb CACs) those restructured bonds with (a subset of) the remaining unrestructured bonds. If "PAC-man" is applied iteratively and combined with redesignation, it could (in theory) result in a consenting minority of bondholders cramming down a dissenting majority (Clark and Lyratzakis, 2021).

Obviously, this has raised concerns in the international creditor community. In both the Argentine and Ecuadorian restructurings, creditors responded by negotiating specific fixes with the respective debtors. In both cases, the parties agreed to adopt language in the new exchange bonds to clarify that redesignation of voting pools and "PAC-man" will only be permitted under specific circumstances (IMF, 2020b). These qualified restrictions adopted in the restructurings of Ecuador and Argentina may ultimately enhance the ICMA model (which is currently being reviewed) and provide strong incentives for a sovereign to engage constructively with its private creditors (Clark and Lyratzakis, 2021).[35]

4.3 The way forward with CACs

Although the uptake of enhanced CACs has generally been good, and recent experiences in Ecuador and Argentina seem rather promising, there are some remaining issues with respect to contractual provisions. Setting aside the well-known

[35] For a more detailed record of these issues and specific fixes, see Clark and Lyratzakis (2021), De la Cruz and Lagos (2021), and Buchheit and Gulati (2020).

outstanding stock problem, there are concerns that CACs are absent in other bonds indirectly related to the general government, such as international bonds issued by sub-sovereigns[36] or state-owned enterprises, and the fact that syndicated bank loans often also lack majority restructuring provisions for payment terms (IMF, 2020b).

Based on these considerations, the following avenues of action could be proposed:

- First, the IMF should continue its active endorsement of the inclusion of enhanced CACs (including the single-limb voting option) in international sovereign bonds issued under all jurisdictions.
- Second, it would also be important to promote the inclusion of enhanced CACs in international bond contracts of sub-sovereign entities and state-owned enterprises.
- Third, while majority restructuring provisions in syndicated bank loans could facilitate, at least in principle, orderly SODRs, they have not been tested so far. Thus, the IMF should continue to monitor concrete cases of SODR in the future, and assess whether the lack of majority restructuring provisions in syndicated bank loans could adversely affect these processes. If this is the case, the IMF could propose the adoption of appropriate provisions.
- Fourth, the IMF should continue to proactively follow the development of new contractual standards. Fund staff should continue to engage with relevant financial market organisations such as ICMA (which is now again in the process of reviewing the appropriateness of its model CACs in the light of the Ecuador and Argentina experiences).
- Finally, the Fund could engage bilaterally with its members to motivate them to include state-of-the-art CACs (or majority restructuring provisions in bank loans), both in the context of surveillance and programme conditionality.

4.4 Pros and cons of possible state-contingent debt instruments

The potential benefits of state-contingent debt instruments (SCDIs) are unquestionable. In terms of crisis prevention, SCDIs can promote risk-sharing between debtors and creditors and increase debt structures' long-term resilience to shocks, thus making defaults and future restructurings less likely. From a theoretical point of view, symmetric instruments based on a variable strictly linked to the borrower's debt sustainability and capacity to repay could be especially beneficial in

[36] In Argentina, there is believed to be about USD 15 billion of outstanding (foreign-held) provincial debt, a significant part of which is the subject of ongoing debt restructurings and/or already in default. According to Mander (2020), many Argentinian provinces are squeezed between creditors, who are looking for fair, negotiated debt restructurings calibrated on each province's economic situation, and the national government, which pushes for large across-the-board haircuts in order to help stabilise public finances and save on the country's FX reserves. While recently issued Argentinian provincial bonds do include enhanced CACs, a limited survey by the IMF (2020a) suggests that the inclusion (and type) of CACs varies among foreign law-governed sub-sovereign bonds.

a context, like the current one, of high debt and low fiscal space. Moreover, design options and payout formulas can be tailored to address various purposes, and to deal with solvency as well as liquidity issues (see Annex A.5).[37]

Proponents of SCDIs have also highlighted that a subcategory of these instruments (Value Recovery Instruments or "VRIs") can facilitate debt restructurings, and therefore strengthen the market-based approach to SODRs. Especially in a situation of high uncertainty, such as the one induced by the COVID-19 shock, VRIs could help bridge the gap between creditors and debtors' economic outlook, thus reducing conflicts over current valuations and encouraging creditors' participation in the resolution process (by incentivising them to provide upfront debt relief in exchange for a potential higher payoff in later years).

Despite the clear advantages of these instruments, take-up by the market has been limited so far, with occasional use in restructuring contexts and rare issuance in normal times. Large institutional investors (such as insurance companies, pension funds and fixed-income mutual funds) generally prefer standard debt instruments, which are more liquid and easier to understand and price. The valuation uncertainties and the low level of liquidity have often resulted in large bid-ask spreads, reducing investors' interest, and in a high-risk premium – increasing the cost for potential borrowers.[38] In addition, political economy constraints (related to governments' short-term horizon) may have discouraged issuance by sovereign debtors.

In the current environment, another important aspect to consider is the range of sovereign debtors potentially involved in restructurings. The use of SCDIs for only a few countries with specific characteristics (e.g. a limited subset of DSSI-eligible countries) would call for instruments with bespoke state variables closely tailored to the capacity to repay. In this regard, and as confirmed also by past experience[39], carefully designed SCDIs could be effective in providing customised payment flexibility to countries exposed to very distinctive vulnerabilities – targeting a narrow base of investors. On the other hand, the application to larger EMEs would be quite problematic at this stage, as this would imply the need to develop a more scalable solution, with more standardised terms, to promote secondary market liquidity and index inclusion; necessary to attract a wider investor base.

To conclude, further consultation with the private sector is necessary to fully grasp investors' appetite for the various contractual solutions. A model set of clauses for GDP-linked sovereign bonds drafted in 2017 by a group of market participants, lawyers and economists ("London term sheet")[40], has failed so far to

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[37] On SCDIs, see among others: Barr et al. (2014) Brooke et al. (2013), IMF (2017a), IMF (2020d), Kim and Ostry (2021).

[38] IMF (2020d and 2017a). Measurement and manipulation issues in relation to the state variable are additional factors that can increase the idiosyncratic risk profile of state-contingent debt instruments.

[39] For example, contingent instruments with clauses protecting small states against rare events like natural disasters (the so-called "Hurricane Bonds") have been more successful than more general instruments in providing risk-sharing of economic fluctuations (such as GDP or commodity-linked bonds), attracting specialised investors offering insurance against catastrophic risk.

[40] https://www.icmagroup.org/assets/documents/Resources/GDP_Bond_Termsheet_Oct.-2017-Version-060318.pdf .

spur market development, indicating that the practical constraints should not be downplayed. While at this juncture the active promotion of SCDIs may not be a key priority for the official sector, including the IMF, further consultation with the private sector and sovereign debt managers could be useful.

4.5 Monitoring "anti-vulture fund" legislation

As reforms to the contractual framework take time to become effective and cannot fully eliminate the risks posed by litigious holdout creditors[41], they have been complemented with targeted legislative solutions aimed at containing the expected profits of holdout strategies. A few countries, notably, Belgium, France, and the United Kingdom, have resorted to domestic legislative initiatives, the so-called "anti-vulture fund" laws. These laws vary greatly in scope, with the Belgian law – Loi Relative à la Lutte contre les Activités des Fonds Vautours – of 2015 having the broadest scope.[42] This legislation limits the enforceability of creditors' claims where these are judged to result in an "illegitimate advantage", assessed on the basis of the existence of a manifest disproportion between the price paid by the creditor for the debt on the secondary market and, either the face value of the debt, or the demanded sum, as well as additional criteria (including creditors' litigation track record, their refusal to participate in a process of SODR and/or their incorporation in a tax haven).[43] Even if Belgian courts are seldom competent with respect to foreign debt payment issues (with the exception of debt held in the Euroclear system) and attempts to enforce foreign judgements and attach debtors' assets located in Belgium are very limited (Richelle, 2016), the Belgian law may have a signalling function and could perhaps be used as a blueprint for other national and/or international "anti-vulture fund" legislation (Van de Poel, 2015).[44]

Given the limited applicability of the existing "anti-vulture fund" laws and the fact that none of them have actually been invoked, there is hitherto very little evidence on their effectiveness. While the IMF may not be well placed to study in

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41 Contractual provisions in bond contracts including the pari passu clause and CACs were reformed following Argentina's "pari passu saga", whereby a New York federal judge provided a (deviant) interpretation of a contractual clause, which led to the blocking of payments to restructured bondholders and ultimately a new default by Argentina. See IMF (2014c) and Hébert and Schreger (2017).

42 The 2010 UK law (mirrored by the Isle of Man, Guernsey and Jersey in 2012-2013) focuses on preventing creditors from extracting, through UK courts, payments on the pre-2004 sovereign debt of countries that benefitted from debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative on terms more favourable than agreed under HIPC. The French law only applies to debts purchased after 2016 and restricts court authorisation for the seizure of assets of certain beneficiaries of official development assistance after a default or restructuring.

43 For more details, and the Belgian law's (turbulent) background, see Sourbron and Vereeck (2017), Wozny (2017) and Iversen (2019). Critics of the law have argued that it uses subjective criteria to determine "illegitimacy" and, above all, that it risks undermining secondary market liquidity for distressed debt. In 2016, NML Capital, the hedge fund best known for its litigation against Argentina, sought the annulment of the Belgian law, questioning its constitutionality, but NML's claims were ultimately rejected by the Belgian Constitutional Court in a 2018 ruling.

44 In 2018 the European Parliament called on Member States to adopt, on the European Commission's initiative, a regulation modelled on the Belgian law. In response, the European Commission contracted a report on the subject (Iversen, 2019). At present, there seems to be scant support for a joint European approach. A 2008 US Congressional draft bill attempting to introduce anti-vulture fund legislation in New York Law, under which debtor litigation has been most prevalent, did not produce any concrete follow-up.

great detail the feasibility and desirability of extending this kind of legislation to other jurisdictions (let alone actively promote it), the Fund should approach any new statutory initiatives with a critical, yet open, mind.[45] When consulted by member countries, the Fund's legal experts could help assess new legislative proposals related to SODR, and monitor these proposals' compatibility with the existing international principles governing sovereign debt treatment.

45 For recent proposals of targeted legislative tools other than anti-vulture fund laws, see e.g. Buchheit and Gulati (2018), Hagan (2020) and Buchheit and Hagan (2020).

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Annexes

A.1 – Debt sustainability assessment: main innovations of the new Sovereign Risk and Debt Sustainability Framework for Market Access Countries

Enhanced debt coverage: General government is the default coverage, with justification being required for narrower coverage. Improved disclosure on debt coverage (metadata on institutional and instrument coverage, accounting principles and consolidation) is foreseen, as well as enhanced reporting of debt profile vulnerabilities, notably comprising holder profile. Expanded coverage may be needed to fully grasp risks and mitigants, including those stemming from central banks' activities. A stress test on contingent liabilities related to narrower debt coverage is foreseen in the medium-term risk analysis.

A longer projection horizon (10 years) and a horizon-based approach to assess sovereign risks: Risks are assessed for the near, medium, and long-term horizons – based on new tools and analytical methods that account for country-specific structural characteristics.

Enhanced realism tools: New tools have been included to encompass all debt drivers (exchange rate, financing terms on external debt, and stock-flow adjustments) and capture the various components of the broader definition of public debt. Additional tools have also been introduced to assess the realism of fiscal multipliers and potential growth.

Near-term risk analysis: Stress indicators are organised in five categories (quality of institutions, stress history, cyclical, debt burden and buffers, and global). A multivariate logistic regression combines the indicators into a single continuous probability of stress metric, with countries being assigned to one of three sovereign stress zones (low, moderate, high) – the near-term mechanical risk signal.

Medium-term risk analysis: The analysis is based on three modules: (a) a debt fan chart, to assess prospects for debt–to-GDP stabilisation in a probabilistic way; (b) a "gross financing needs" (GFN) tool, to analyse financing risks; and (c) tailored stress tests that simulate debt and GFN paths, to capture country-specific risks. The first two modules lead to aggregated indexes, which are then aggregated into a single Medium-Term Index (MTI), divided into three risk zones (low, moderate, and high). The results of the tailored stress tests complement the previous analyses and may be used to modify the MTI in the final medium-term risk assessment.

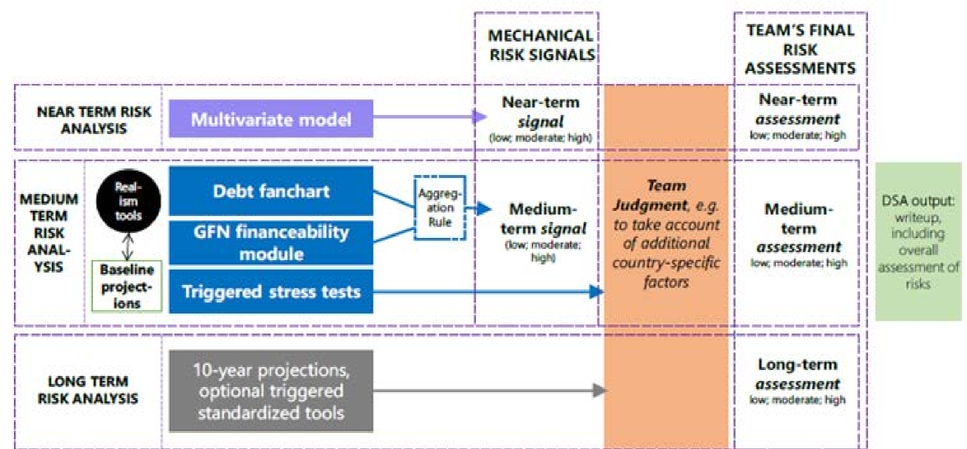
Long-term risk analysis: A 10-year horizon for debt and GFN projections is included, as well as a suite of optional tools to analyse specific vulnerabilities (ageing, natural resources, large debt amortisations, climate change) and inform staff's judgement – with no mechanical risk signal.

Judgement and final risk assessment: The final risk assessment for each horizon will be informed by staff's judgement, with deviations from mechanical signals explained in the write-up. The final overall risk assessment will also be based on team judgement, with a presumption that it will remain within the range of risk assessments for each horizon.

Debt sustainability assessments: The new tools will be used to derive probabilistic debt sustainability assessments, as required by the Fund's lending framework for all programme cases (optional in surveillance). Outputs from the debt fan chart module, the GFN module and a crisis prediction model calibrated on past episodes of unsustainable debt will be aggregated – leading to a mechanical signal on debt sustainability (sustainable with high probability; sustainable, but not with high probability; not sustainable). Judgement will complement this mechanical signal, leading to a bottom-line assessment on debt sustainability. The precise aggregation method and index cut-offs will remain confidential due to potential market-sensitivity. Three-zone debt sustainability assessments will now be disclosed to the Board in both normal and exceptional access cases and will continue to be disclosed to the public only in exceptional access cases, with the experience assessed at the end of a 12-month transition period.

Figure 1

The architecture of the proposed MAC SRDSF



Source: IMF (2021)

A.2 – Argentina 2018-19. Exceptional access criteria and financing assurances

Debt sustainability – Based on a debt sustainability analysis (DSA), Argentina's public debt was assessed as "sustainable but not with a high probability" (the "grey zone") from the SBA's request in June 2018 until the fourth and final review in July 2019. It is somewhat striking that this assessment was maintained, despite the fact that projected debt-to-GDP levels rose throughout the four programme reviews from 65% to 86% in the baseline scenario. Risks to debt sustainability were gauged to be significant from the first review onwards, due to: large overall external financing needs, large share of FX-denominated debt, significant rollover needs and potential contingent liabilities. However, mitigating factors were also recognised. At the same time, the results of consecutive DSA updates for the adverse scenarios (with debt-to-GDP up to 103% or even 160% under the combined macro-financial stress test scenario, and heat maps eventually becoming almost entirely "red") were significantly deteriorating over time. These risk analyses were only included in the DSA annex and not in the discussion in the main part of the report, thereby drawing less attention. Overall, this dichotomy between unchanged headline assessments and clearly deteriorating evidence on the risks attached to the programme seems to testify the ample room for discretion available to the IMF when interpreting the debt sustainability criterion.

Programme success, including the institutional and political capacity to deliver the adjustment – The institutional and technical competence of the Macri administration was seen as strong and able to deliver on the SBA's commitments. However, concerns were expressed in regard to the government's ability to build support for policy measures in Congress – where the governing coalition was in a minority in both houses – and to develop a social consensus around the main parts of the programme, taking into account the difficult history of IMF lending to Argentina.

Prospective financing from other sources – Exceptional access in the "grey zone" was considered justified by staff as financing from non-IMF sources "improved debt sustainability and sufficiently enhanced the safeguards for Fund resources". This referred mostly to "adequate private creditor exposure" being maintained throughout the programme, as contributions from other IFIs were minor.[46] In the Fund's view, adequate private creditor exposure prevailed thanks to the following factors. First, there was continued access to domestic markets. Second, there was a significant share of sovereign liabilities held by investors (including domestic financial institutions, retail investors but especially other public entities, which held "about 40%" of total federal debt) expected to maintain their positions even amid stressed conditions. Third, Argentina's privately-held, FX-denominated debt had long maturities. However, following the market turmoil after the presidential poll in

[46] More specifically, at the Argentine SBA's request in June 2018, with the initial size of the IMF programme of around USD 50 billion (further augmented afterwards), only USD 1.75 billion of new support from the World Bank and USD 0.6 billion from IDB was reported for the first 12 months of the programme. In the later programme documents, the overall IFIs' contribution was reported at around USD 1 billion for 2018, and projected to amount to around USD 3.5 billion in 2019 and slightly below USD 3 billion in both 2020 and 2021.

summer 2019, risks to debt sustainability materialised, rendering Argentina's debt unsustainable, as subsequently assessed by IMF staff in February/March 2020. While risk analyses had pointed to gradual deterioration, the change in the headline assessment occurred in just a matter of months after the programme was already off track, which may raise questions about the credibility of the IMF DSA's signalling effect.

A.3 – The Fund's lending into arrears policies

The LIA and LIOA policies apply across all Fund arrangements, including under the PRGT. They may play the role of a critical backstop to debtor-creditor negotiations, by setting incentives for a less confrontational restructuring process (Hagan, 2020). Under these policies, the IMF is prepared to support a programme when upfront debt relief has not yet been secured and arrears have materialised. In this way, the debtor obtains greater leverage when creditors are unwilling to provide the necessary relief consistent with the parameters of an IMF programme. In the absence of LIA/LIOA policies, the IMF's non-toleration policy would have given individual creditors an effective (and unwarranted) veto power on Fund-supported programmes. LIA/LIOA policies eliminate this veto power and therefore contribute to smoothing the debt restructuring process.

At the same time, lending to countries in arrears bears additional risks for the Fund and requires special safeguards to be in place. (The legal basis is provided by Article III Section 3(a), which requires the establishment of "adequate safeguards for the temporary use of the general resources of the Fund".) For this reason, the application of these policies is determined on a case-by-case basis, in connection with certain conditions that must be met at each programme review, with each disbursement being subject to a financing assurances review.[47]

Both of the IMF's lending into arrears policies are subject to the fulfilment of certain general criteria. First, prompt financial support from the Fund must be considered essential, and the member must be pursuing appropriate policies. Second, the debtor should be making "good faith" efforts to reach collaborative agreement with its creditors on a contribution consistent with the parameters of the Fund-supported program, and the failure to reach this agreement must be due to the creditors' unwillingness to provide such a contribution.[48] In the case of arrears vis-à-vis official bilateral creditors, Fund lending is only permitted under the additional condition that the decision to provide financing despite the arrears, would not have undue negative effects on the Fund's ability to mobilise official financing packages in future cases.

[47] This applies also to minor arrears, which may not require a broad-based debt restructuring operation. In exceptional circumstances, however, the Fund may provide financing under the Rapid Credit Facility (RCF) or the Rapid Financing Instrument (RFI) despite arrears owed to official bilateral creditors and without assessing whether the three criteria above have been satisfied or obtaining the creditor's consent.

[48] At its introduction in 1989, the LIA policy was limited to commercial banks, but later it was broadened to encompass arrears on bonds and other non-bank forms of financing from private creditors. In particular, the good faith criterion was intended to address specific issues related to bond restructurings, including concerns that negotiations with bondholders could be more protracted (or reach a stalemate), as well as the risk of litigation. See IMF (2002a).

The latter condition provides a higher level of protection to official bilateral creditors as opposed to private creditors, within the Fund's policy framework.

The criterion on good faith negotiations is the central element common to both policies.[49] In 2002, the Fund formulated three broad principles to guide the dialogue between debtors and their private external creditors: (a) initiating an early dialogue with creditors; (b) timely information sharing with all creditors[50]; and (c) allowing for creditors' input (IMF 2002b). The exact form of the dialogue was left to the debtor and its creditors, except where an organised negotiating framework was warranted by the complexity of the case (see below on creditor committees). These principles tried to strike an appropriate balance between clarity and flexibility in guiding the debtor-creditor dialogue. Through greater clarity about the good faith dialogue, the IMF sought to provide better guidance on LIA policy application and, more generally, to promote a better framework for the engagement of debtors and creditors in the sovereign debt restructurings.[51] At the same time, the IMF wished to maintain flexibility to: accommodate the characteristics of each specific case, avoid putting debtors at a disadvantage in the negotiations with creditors, and avoid prolonged negotiations that could hamper the ability of the Fund to provide timely assistance.

Another important aspect of the debtor-creditor relations for LIA purposes is the definition of a "representative" creditor committee with which to negotiate in complex restructuring cases. In such cases, the Fund expressed a preference to have an organised negotiation framework based, inter alia, on the sharing of confidential information as well as on possible standstills on litigation agreed by the creditor committee during the restructuring process – provided, that creditors could establish such a committee on a timely basis. The IMF had to make a judgement about the complexity of the restructuring case, and assess whether a reasonable period had elapsed to allow the establishment of a sufficiently representative creditor committee.

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49 Initially, the LIA policy did not contemplate any good faith criterion. Instead, it required that: (a) negotiations between the member and its commercial bank creditors on a restructuring had begun, and (b) the expectation to agree a financial package consistent with external viability within a reasonable period.

50 Such information 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 programme to address the underlying problems and its implications on the broad financial parameters shaping the envelope of resources available for restructured claims; (iii) the provision of a comprehensive picture of the treatment of all domestic and external 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.

51 Greater clarity would strengthen the capacity of investors to assess recovery values under alternative scenarios, thereby facilitating the pricing of risk and improving the functioning of the capital markets.

A.4 – Comparability of treatment, as defined by the Paris Club

The Paris Club is an informal group of official bilateral creditors (mostly OECD countries) whose role is to find coordinated and sustainable solutions to the payment difficulties experienced by debtor countries. The Club was set up in the mid-1950s, initially to provide a venue for debt restructuring negotiations with Argentina. The Paris Club has no legal personality and is not backed by an international treaty. It has rather been acting as an international conference dealing with resolution of official debt strongly linked to Bretton Woods institutions. Until the 1990s, the Club even lacked a formal membership: its negotiations were open to all the creditor countries having substantial exposure to a specific debtor country and ready to accept its consuetudinary principles and procedures.

The Paris Club Agreed Minutes always include a "comparability of treatment" clause, which aims to ensure balanced treatment of the debtor country's debt by all external creditors.[52] In accordance with this clause, the debtor country undertakes to seek from non-multilateral creditors, in particular other official bilateral creditor countries that are not members of the Paris Club and private creditors (mainly banks, bondholders and suppliers), a treatment on comparable terms to those granted in the Agreed Minutes.

Paris Club creditors do not expect the debtor's agreements with its other creditors to exactly match the terms of the Paris Club's own agreement. Instead, given the diversity of other possible creditors, they require that the debtor seeks terms "comparable" to the Paris Club's agreement. They also require the debtor to share with the Paris Club the results of its negotiations with other creditors. In practice, Paris Club creditors take a broad-based approach in their assessment of whether a debtor has met the comparability of treatment requirement. Factors for assessing comparability include, for each type of creditor, changes in nominal debt service, net present value and duration of the restructured debt. No kind of debt instrument is inherently protected from treatment. However, Paris Club creditors do consider, on a case-by-case basis, whether mitigating factors argue against demanding comparable treatment from a particular creditor or on a particular debt instrument. They can make exceptions, for example, when the debt only represents a small proportion of the country's debt burden and when restructuring would unduly interfere with the smooth running of trade. Short-term trade finance is generally excluded from Paris Club rescheduling.

Non-Paris Club official bilateral creditors are expected to grant medium or long-term loans generally similar to those provided by Paris Club creditors, and restructure their claims on terms very similar to those agreed within the Paris Club. These creditors may also participate in Paris Club treatments and, under these circumstances, apply exactly the same treatment as that applied by Paris Club creditors.

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[52] This Annex is based on information available on the Paris Club's website. See https://clubdeparis.org/en/communications/page/what-does-comparability-of-treatment-mean.

In contrast, debtors' relations with external private creditors are more complex. There is a long track record of international banks rescheduling their exposures to sovereign borrowers, through the (now defunct) “London Club” or ad hoc creditor committees. The Paris Club's experience is that it can be more difficult to make a direct comparison between the efforts of creditors that choose to reschedule payment flows and those that restructure their stocks of claims. For example, in recent cases where debtors have sought financial relief from bondholders, the debtors have offered new bonds in exchange for the existing instruments. As a rule, comparability of treatment is assessed on the basis of the effect of private treatments compared to the effect of Paris Club treatments (in terms of duration, net present value and flow relief).

A.5 – A taxonomy of state-contingent debt instruments

Unlike traditional sovereign bonds or loans, state-contingent debt instruments (SCDIs) have payouts that depend on future outcomes (higher in “good states” of the world than in “bad states”), based on the value of a state variable. The latter is generally a variable closely linked to the sovereign’s debt service capacity (such as GDP, exports, or commodity prices), in order to provide debt stabilisation benefits and create policy space in case of shocks. Design options can be tailored to various purposes, and deal with solvency or liquidity issues. While acknowledging the importance of practical constraints holding back market development (see main text), from a theoretical point of view there are several potential useful applications of different types of SCDIs:

- Instruments providing upside payouts under positive scenarios (“Value Recovery Instruments” or VRIs) may facilitate restructurings by making creditors less reluctant to accept a level of losses (haircut) based on a conservative baseline scenario of future macroeconomic developments, as the deal is “sweetened” by the benefits arising in the case of a faster-than-anticipated economic recovery. This could also ease the policy adjustment burden for the country and reduce the size of the IMF’s financial involvement. First introduced during the Brady restructurings of the 1980s, VRIs have been used sporadically and reappeared (in the form of upside GDP-linked warrants) in a few more recent restructurings (Argentina in 2005 and 2010, Greece in 2012 and Ukraine in 2015). Overall, the track record of these instruments in improving debt restructuring outcomes is mixed, and two recent significant debt restructurings (Argentina and Ecuador) did not include VRIs.

- Instruments providing downside protection under negative scenarios, which function like insurance contracts by giving relief to borrowers (either in the form of interest forbearance, maturity extensions, or principal forgiveness) following large negative shocks, such as natural disasters. Adopted during recent debt restructurings involving Caribbean countries that are exposed to hurricanes and other natural disasters, this type of contingency may be increasingly relevant given growing risks due to climate change and other environmental concerns.

- Instruments with symmetric payoffs (e.g. GDP-linked bonds), providing both upside payouts to creditors under positive scenarios and downside protection to borrowers under negative scenarios. The current conjuncture of high economic uncertainty could increase the scope for exchange bonds with symmetric payoffs to be used in debt restructurings, by facilitating an agreement between debtors and creditors on the baseline and the debt targets.

- Instruments providing automatic debt standstills under "pandemic" or other global crisis conditions, which can be considered an extension of natural disaster clauses to a broader context. This type of instruments faces considerable implementation challenges, including the complexity of delineating triggering events[53]. A potentially useful innovation could be the introduction of clauses linking a temporary debt service suspension and maturity extension to signals of market disruption, such as an abrupt jump in emerging markets' bond yields or a coordinated debt relief action by official creditors. This latter type could facilitate private sector participation in official debt relief efforts, which has been one of the main implementation challenges of the G20 DSSI.

[53] The World Bank's pandemic bonds are a case in point. See https://www.ft.com/content/73275097-d2cd-4b78-b693-08e8fa00436c.

List of abbreviations

BIS	Bank for International Settlements
CACs	Collective action clauses
DSA	Debt sustainability assessment
DSF	Debt sustainability framework
DSSI	Debt Service Suspension Initiative of the G20
EAP	Exceptional access policy of the IMF
EFF	Extended Fund Facility of the IMF
EMEs	Emerging market economies
ESM	European Stability Mechanism
FX	Foreign exchange
G20	Group of Twenty
GCAB	Global Committee of Argentina Bondholders
GFN	Gross financing needs
ICMA	International Capital Markets Association
IDA	International Development Association
IIF	Institute of International Finance
IMF	International Monetary Fund
IRC	International Relations Committee
LIA	Lending into arrears with private creditors
LICs	Low-income countries
LIOA	Lending into arrears with official creditors
MACs	Market-access countries
MTI	Medium-Term Index
OECD	Organisation for Economic Cooperation and Development
PCS	Preferred creditor status
PPAs	Performance and policy actions
PPG	Public and publicly guaranteed
PRGT	Poverty Reduction and Growth Trust of the IMF
RCF	Rapid Credit Facility of the IMF
RFAs	Regional financing arrangements
RFI	Rapid Financing Instrument of the IMF
SBA	Stand-By Arrangement of the IMF
SCDIs	State-contingent debt instruments
SDFP	Sustainable Development Finance Policy of the World Bank
SDRM	Sovereign Debt Restructuring Mechanism
SODR	Sovereign debt restructuring
SRDSF	Sovereign Risk and Debt Sustainability Framework
UCT	Upper credit tranche
UN	United Nations
UNGA	United Nations General Assembly
VRIs	Value recovery instruments

List of Task Force members

Marco Committeri (Chair)
Banca d'Italia

Inês Alves
Banco de Portugal

Julien Arthur
Banque de France

Raffaele De Marchi
Banca d'Italia

Dennis Essers
Nationale Bank van België/Banque Nationale de Belgique

Mary Keeney
Central Bank of Ireland

Patrick Kosterink
De Nederlandsche Bank

Alexander Lieber
Deutsche Bundesbank

José Ramon Martinez-Resano
Banco de España

Joanna Osińska
European Central Bank

Francesco Spadafora
Banca d'Italia

Roman Vasil
Národná banka Slovenska

Benjamin Vonessen
European Central Bank

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Postal address 60640 Frankfurt am Main, Germany
Telephone +49 69 1344 0
Website www.ecb.europa.eu

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