PRINCIPLES FOR STABLE CAPITAL FLOWS AND FAIR DEBT RESTRUCTURING

2021 ANNUAL REPORT

FEATURING AN INTERIM REPORT ON UPDATING THE *PRINCIPLES*

WITH CONTRIBUTIONS FROM THE PRINCIPLES CONSULTATIVE GROUP

OCTOBER 2021

TRANSPARENCY **COOPERATION** **GOOD FAITH** **FAIR TREATMENT**

Table of Contents

I. Overview ... 3

Box 1. PCG Discussions of Country Cases ... 7

II. A Short History of the *Principles for Stable Capital Flows and Fair Debt Restructuring* ... 10

III. Work of the PCG and the IIF Committee for Sovereign Risk Management to Convey Private Sector Perspectives and Facilitate Private Sector Participation with respect to the G20/Paris Club Debt Service Suspension Initiative (DSSI) and the Common Framework for Debt Treatments beyond the DSSI ... 12

Box 2. The Private Sector and the DSSI ... 17

IV. Creditor Committees and Sovereign Debt Restructuring ... 19

V. Reconciling Differences between the Principles and IMF Policies ... 25

Box 3. IMF Lending into Private Arrears Policy and Pre-default Restructurings ... 27

Box 4. IMF Debt Limits Policy ... 29

VI. Refinements to the Use of Collective Action Clauses ... 30

Box 5. UK G7 Private Sector Debt Working Group ... 32

VII. Transparency and The Timely Flow of Information ... 33

Box 6. Update on IIF *Voluntary Debt Transparency Principles* ... 35

Box 7. Official Sector Efforts to Enhance Debt Transparency ... 36

VIII. New Instruments for Sustainable Financing ... 38

IX. ESG Considerations for Sovereign Debt Restructuring ... 42

Box 8. Greening EM Bond Markets ... 45

X. The Case for Nature-Based Solutions ... 46

XI. Sovereign Debt Instruments with Catastrophe and Disaster-related Features ... 48

XII. Ratings Considerations in Sovereign Debt Markets ... 51

ANNEX I. The Principles For Stable Capital Flows And Fair Debt Restructuring ... 54

ANNEX II. Addendum To The Principles For Stable Capital Flows And Fair Debt Restructuring ... 58

ANNEX III. Members Of The Group Of Trustees Of The Principles ... 63

ANNEX IV. Principles Consultative Group ... 65

ANNEX V. Members Of The PCG Working Group On Updating The Principles ... 67

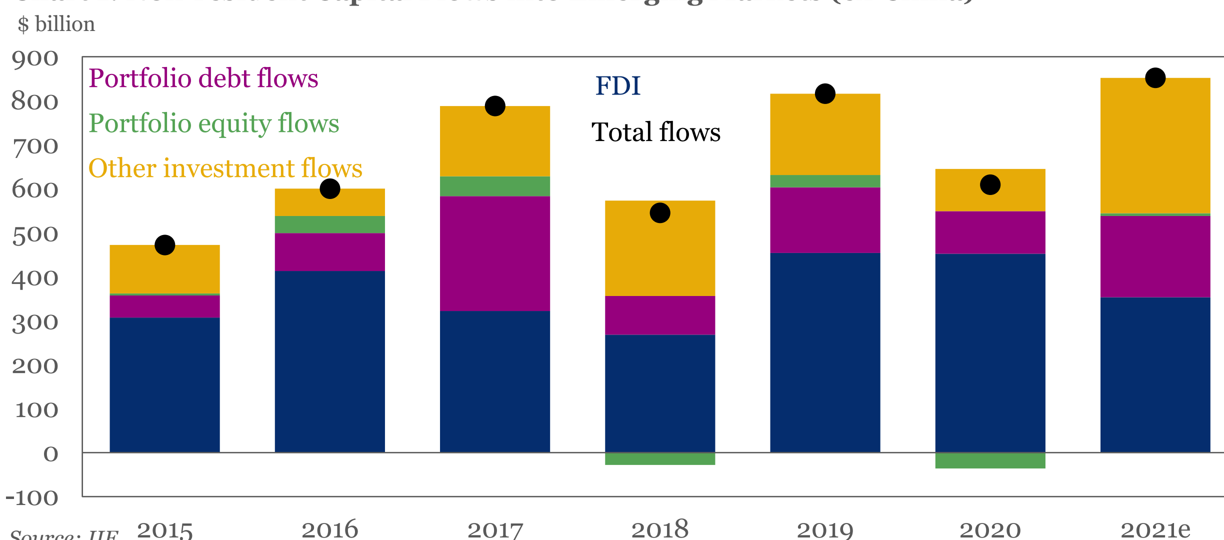
ANNEX VI. IIF Best Practices For Investor Relations ... 68

ANNEX VII. IIF Best Practices For Formation And Operation Of Creditor Committees ... 73

I. Overview

After a challenging 2020, prospects for the global economy have improved this year as pandemic headwinds begin to fade and financial conditions remain broadly accommodative across mature and emerging market economies. The global economy is expected to rebound by 5.8% in 2021, following a sharp contraction of 3.3% in 2020. However, the economic recovery remains highly uneven, amid significant uncertainty about the path of the pandemic in many parts of the world. These factors continue to weigh on the outlook for capital flows to emerging markets. According to the [latest estimates] from the Institute of International Finance (IIF), non-resident capital inflows to the 24 major emerging markets (excluding China) monitored by the IIF are expected to reach over $850 billion in 2021 (Chart 1), largely driven by the most recent allocation of Special Drawing Rights (SDR) by the International Monetary Fund (IMF). Excluding the SDR allocation, total private flows are expected to rise from $608 billion in 2020 to $700 billion in 2021—well below the pre-pandemic peak of over $800 billion in 2019. This modest recovery in private capital flows is expected to be driven by portfolio debt and cross-border banking flows, reflecting the rise of sectoral indebtedness across many emerging markets and developing economies (EMDEs).

Chart 1: Non-resident Capital Flows into Emerging Markets (ex-China)



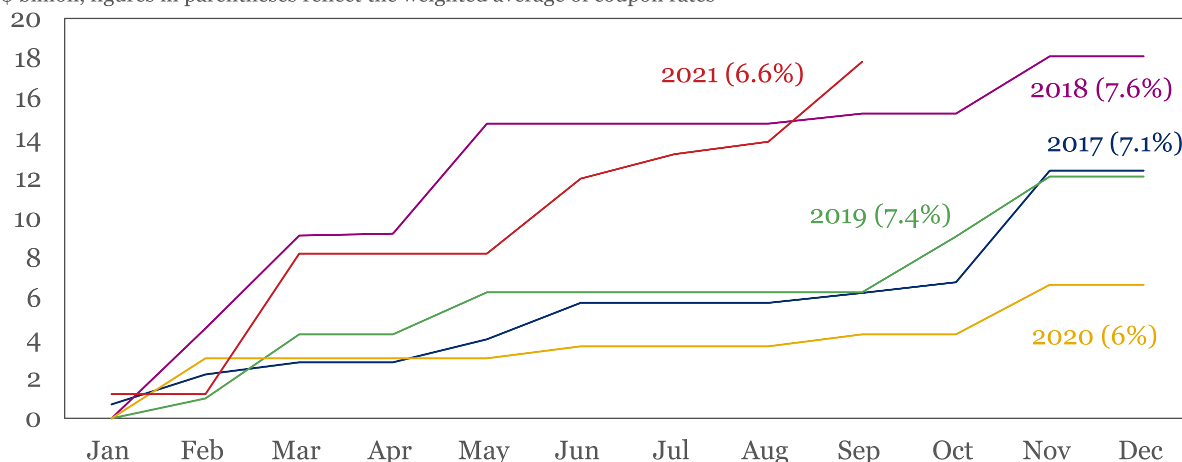
Lockdowns, travel restrictions, and other policies to combat the pandemic have driven a surge in debt levels around the world, even as many EMDEs have limited resources to contain the health crisis and service debt. As noted in our latest [Global Debt Monitor], the pandemic has brought total debt in emerging markets (excluding China) to a fresh record high of over $36 trillion in H1 2021—up over $3 trillion since the onset of the pandemic. The rise was largely driven by governments as many EM sovereigns have stepped up borrowing significantly, with the median EM government debt level now around 15% higher than in 2019.

Following a record number of sovereign defaults in bonded debt in 2020, near-term sovereign debt vulnerabilities have eased significantly, back to pre-pandemic levels—thanks to abundant central bank liquidity and support from the international financial institutions (Table 1). There have been only three sovereign bond defaults to date in 2021: the first from Zambia which was already in default on its Eurobonds, while Belize and Suriname launched consent solicitations to defer payments (See Box 1). The extension of the G20's Debt Service Suspension Initiative (DSSI) through end-2021 has allowed 48 low-

income and lower-middle-income countries (LLMICs) to postpone over $5 billion in interest and principal payments on loans due to G20 bilateral creditors In addition, Chad, Zambia and Ethiopia have requested restructuring of their debt under the Common Framework for Debt Treatments beyond the DSSI agreed by the G20. However, projections that other countries would also seek debt treatment under the Common Framework have proven unfounded to date, in large part due to abundant global liquidity (financial conditions in most mature economies remain at their most accommodative levels in over two decades). Moreover, during the pandemic, multilateral creditors have significantly increased liquidity support to LLMICs while many of these countries have successfully tapped domestic bond markets to fund the higher budget deficits needed to support recovery. It is notable that private creditors through bonds and loan markets have provided substantial liquidity to DSSI-eligible countries during the course of the DSSI (See Box 2). After a sharp contraction in 2020, Eurobond issuance by DSSI-eligible sovereigns has picked up this year, with Benin, Cameroon, Ghana, Kenya, Maldives, Nigeria, Rwanda, Pakistan, and Senegal tapping international bond markets for the first time since the onset of the pandemic (Chart 2).

Chart 2: For DSSI countries, access to Eurobond markets has improved over the past year

$ billion, figures in parentheses reflect the weighted average of coupon rates

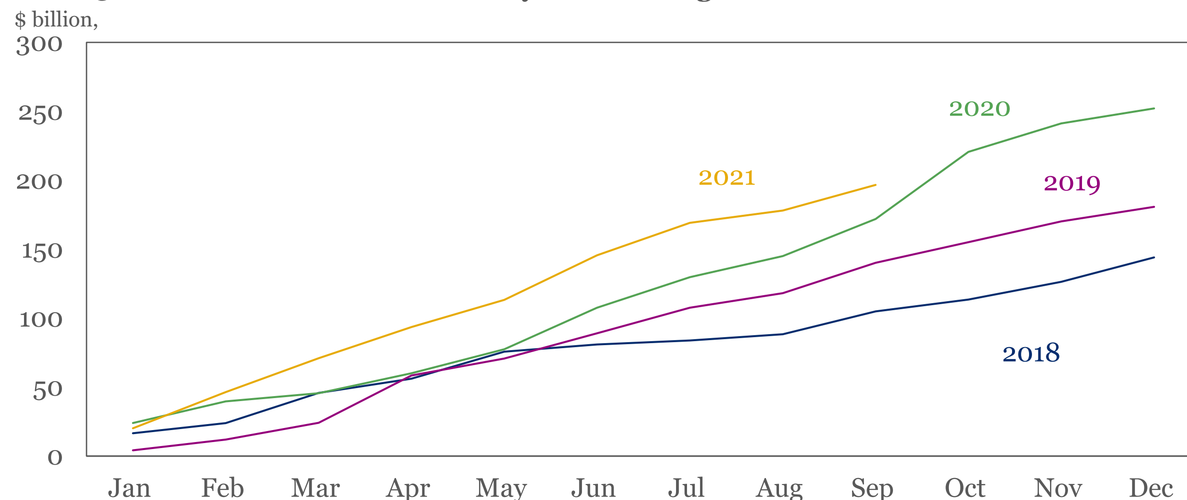


Source: Bloomberg, IIF

In the face of heightened uncertainties around credit risk and market access—that were generated in part by the launch of the DSSI itself—a number of DSSI-eligible sovereigns returned to international bond markets in 2020, albeit at a slow pace. Until Côte d'Ivoire's Eurobond in November 2020, there had been no issuance among the countries that actually have requested relief under the DSSI. Honduras, Mongolia, and Uzbekistan were the other three DSSI-eligible countries that successfully raised capital from external sovereign debt markets in 2020, though to date they have not requested debt service relief from their bilateral official creditors. Moreover, this lack of issuance by DSSI-eligible countries in 2020 stood in sharp contrast to the surge in Eurobond issuance by emerging market sovereigns more broadly that same year (Chart 3). After a short pandemic-induced stall in H1 2020, issuance by other EMs and frontier markets rebounded and subsequently rose to record highs, helped by abundant central bank liquidity. The different speeds at which DSSI-eligible countries and EMs resumed international sovereign bond issuance partly reflects the former group's limited reliance on international bond markets. But perhaps more importantly, the wave of credit ratings downgrades following the launch of the DSSI initiative appears to have weighed

on many DSSI-eligible countries' appetite to tap international capital markets despite improving global liquidity conditions (see Chapter XII). Uncertainty around how participation in DSSI could impact credit ratings—and hence investor sentiment—thus appears to have been a key factor in the slow return of DSSI-eligible countries to international markets in 2020—See IIF Frontier Markets Debt Monitor.

Chart 3: Record Eurobond issuance by EM sovereigns

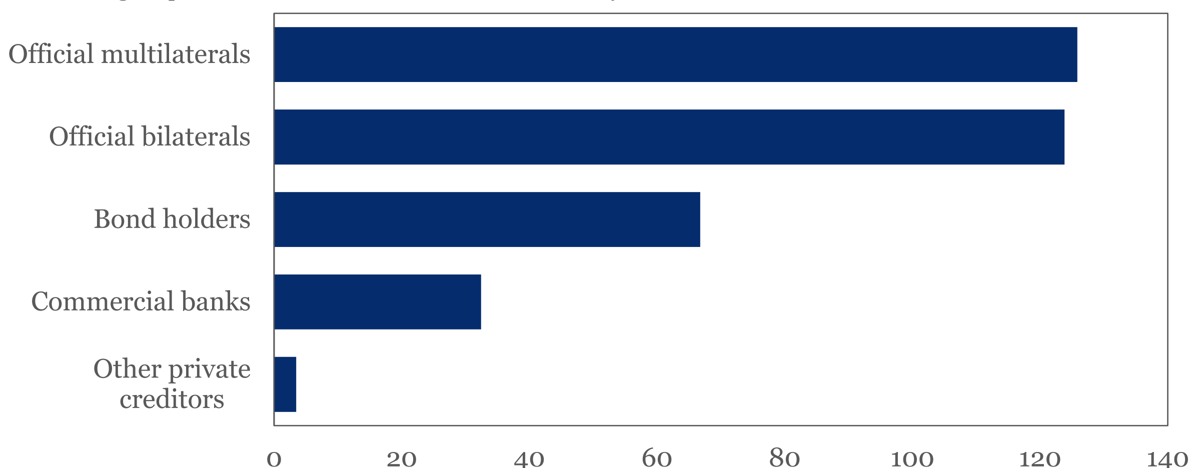


Source: Bloomberg, IIF

Looking ahead, the most recent allocation of Special Drawing Rights (SDRs) by the International Monetary Fund (IMF) should give additional breathing room for many countries over the near-term, including in sub-Saharan Africa. However, more than half of LLMICs are still at high risk or already in debt distress. Rising interest burdens are constraining fiscal capacity and limiting countercyclical fiscal policy. Moreover, considering the massive financing gap that must be addressed to make progress towards Paris Agreement targets and broader Sustainable Development Goals (SDGs), the access of many developing economies to international capital markets remains limited. Although the creditor base of many LLMICs has become more diversified over the past decade, multilaterals remain the largest creditor of many DSSI-eligible countries and the reliance of these countries on non-Paris Club bilateral creditors continue to increase (Chart 4). Achieving the SDGs over the next decade will require LLMICs to have stable and affordable access to international debt markets. This in turn calls for further strengthening of the existing framework for sovereign debt crisis prevention and resolution; the guidelines provided in the *Principles* are an integral part of this framework.

Since their endorsement by the G20 in 2004, the *Principles for Stable Capital Flows and Fair Debt Restructuring* have proven to be an effective framework for sovereign debt crisis prevention and crisis resolution that is widely referenced by debtors, official and private creditors, international financial institutions, and other stakeholders. The *Principles* emphasize sound policies and transparency on the part of debtors, voluntary, cooperative debtor-creditor dialogue and good faith debt restructuring negotiations. However, recognition of the changes in sovereign debt markets over the past decade, lessons learned from recent debt restructurings, the emergence of the DSSI and Common Framework, and the surge in investor interest in environmental, social and governance (ESG) considerations all underscore the need to update the *Principles*.

Chart 4: Official creditors remain the largest creditors of DSSI-eligible countries
$ billion, change in public external debt between 2020 and 2010, by creditor



Source: World Bank, IIF

Against this backdrop, the Principles Consultative Group (PCG) launched a working group in May 2021 to assess the recent experience with sovereign debt crisis prevention, management, and resolution practices, to draw appropriate lessons, and to make recommendations on how best to strengthen the existing *Principles* to ensure stable capital flows and fair debt restructuring. These recommendations focus on a number of topics including:

1. Promoting best practices in the formation of **creditor committees**, or a steering group in the event of multiple committees (Chapter IV);
2. Addressing concerns about **comparability of treatment**, IMF lending into arrears, broader IMF expectations about debtor good-faith engagement with creditors, and the role of Debt Sustainability Analyses in the context of a restructuring (Chapter V);
3. Refining the use of the International Capital Market Association's (ICMA) **collective action clauses** (CAC) framework (Chapter VI);
4. Assessing recent proposals for **reforms to sovereign loan agreements** (Box 5);
5. Strengthening **debt transparency** on the part of all creditors and borrowers; and promoting meaningful and regular **public-private sector dialogue** and consultation (Chapter VII);
6. Addressing scenarios that arise from exogenous events such as climate change and pandemics, including through the use of **state-contingent debt instruments** (Chapter VIII);
7. Integrating **ESG and natural capital considerations** in restructuring negotiations and using new instruments for sustainable financing, e.g. sustainability-linked bonds (Chapters IX, X and XI);
8. Factoring in **ratings considerations** and any relevant impact these may have on sovereign debt markets (Chapter XII).

The PCG anticipates publishing the updated *Principles* ahead of the IMF/World Bank Spring Meetings in 2022. In parallel, the PCG will also review the IIF Best Practices For Formation and Operation of Creditor Committees (see Annex). In light of changes to the *Principles*, the IIF will publish an update to its assessment methodology of countries' investor relations and debt transparency practices (see Annex).

The remainder of this report comprises twelve chapters authored by the PCG working group members. Chapter II provides a short history of the *Principles*, and Chapter III focuses on the work of the PCG and

the IIF Committee for Sovereign Risk Management to convey private sector perspectives and facilitate private sector participation with respect to the DSSI and the Common Framework. The subsequent chapters feature key considerations for an update of the *Principles*. IIF staff would like to thank the PCG for the many robust discussions that informed this report, with special appreciation to the individual chapter authors credited herein.

Box 1. PCG Discussions of Country Cases

Despite the strains faced by emerging markets, there have been relatively few instances of debt restructuring involving sovereign issuers over the past year. The PCG has closely monitored debt treatment efforts under the Common Framework and has discussed ongoing debt restructuring efforts in Belize and Suriname. The group has also received regular updates on developments in Lebanon, Sudan, and Venezuela and briefings on countries with growing debt vulnerabilities, including Sri Lanka and Tunisia.

Debt Treatments State of Play:

The flow of information about the implementation of the Common Framework remains limited. Zambia, Ethiopia, and Chad are the three potentially pending cases of application for the Common Framework, although the conditions for receiving current financing through an IMF arrangement has not been met in any of these cases [at the time of publication of this report].

- The Chad official bilateral creditor committee provided the IMF with official financing assurances in September 2021. Official sector engagement with private creditors in the design of debt restructuring has progressed recently, with a first meeting with private creditors held in early October.
- In Zambia, approval of IMF financing, which is a condition to implementation of the Common Framework, was delayed in part by the country's August 2021 presidential election. In light of rising copper prices, private creditors have noted the need to reconsider the debt sustainability analysis that would inform possible debt restructuring options.
- In September 2021, the first meeting of Ethiopia's official bilateral creditor committee took place more than six months after the country requested Common Framework treatment. Ethiopia has recently requested a new IMF arrangement under the Extended Credit Facility, alongside the arrangement under the Extended Fund Facility, but it is uncertain how Ethiopia intends to bring its IMF-supported economic program back on track.

Following six months of engagement between Belize and the committee of bondholders, Belize launched a cash tender offer and consent solicitation on September 13, 2021. Most bondholders have indicated their support for the proposed transaction, with received tender offers accounting for over 84% of the outstanding dollar bonds due in 2034. As an integral part of the restructuring, Belize committed to allocate around $23.4 million towards environmental conservation measures.

In Suriname, there has been limited progress in debt restructuring negotiations. In April 2021, The IMF reached a staff-level agreement with the country's authorities on a $690 million three-year program under the Extended Fund Facility. Pending approval by the IMF Board, that program has been undergoing revision in light of Suriname's economic performance and due to the need to obtain

outstanding financing assurances from non-Paris Club creditors. In June 2021, Suriname publicly proposed terms of debt restructuring that did not directly reflect the future proceeds from the off-shore oil/gas projects.

On June 28, 2021, the IMF and World Bank approved debt relief for Sudan under the enhanced Heavily-Indebted Poor Countries (HIPC) Initiative. As such, Sudan is now the 38th country to reach the HIPC Decision Point. The IMF projects that HIPC debt relief and other debt relief initiatives anchored to HIPC will reduce Sudan's public external debt by 90% (more than $50 billion) if Sudan reaches the HIPC Completion Point in approximately three years' time.

In Lebanon, efforts on debt restructuring to date have been limited, despite some increasing optimism following the recent formation of a new government.

Given U.S. sanctions, near-term prospects for debt restructuring in Venezuela seem unlikely as there is little scope for creditors to substantially engage with the Maduro administration, which retains effective control in Venezuela.

Table 1: Sovereign Bond Defaults

Country	Default Date	Currency	Status
Russia	Jan-99	FC	resolved
Pakistan	Jan-99	FC	resolved
Indonesia	Mar-99	FC	resolved
Dominican Republic	Apr-99	LC	resolved
Suriname	Jan-00	LC	resolved
Indonesia	Apr-00	FC	resolved
Argentina	Nov-01	FC, LC	resolved
Indonesia	Apr-02	FC	resolved
Paraguay	Feb-03	FC	resolved
Uruguay	May-03	FC	resolved
Cameroon	Sep-04	LC	resolved
Grenada	Dec-04	FC	resolved
Venezuela	Jan-05	FC	resolved
Grenada	Jan-05	LC	resolved
Dominican Republic	Feb-05	FC	resolved
Belize	Dec-06	FC	resolved
Grenada	Dec-06	LC	resolved
Seychelles	Aug-08	FC	resolved
Ecuador	Dec-08	FC, LC	resolved
Jamaica	Jan-10	FC, LC	resolved
Greece	Feb-12	FC, LC	resolved
Belize	Aug-12	FC	resolved
Grenada	Oct-12	FC	resolved
Greece	Dec-12	FC, LC	resolved
Jamaica	Feb-13	FC, LC	resolved
Grenada	Mar-13	FC, LC	resolved
Cyprus	Jun-13	FC, LC	resolved
Argentina	Jul-14	FC	resolved
Ukraine	Sep-15	FC	resolved
Mozambique	Apr-16	FC	resolved
Republic of Congo	Aug-16	FC	resolved
Mozambique	Jan-17	FC	resolved
El Salvador	Apr-17	FC, LC	resolved
Belize	May-17	FC	resolved
Republic of Congo	Aug-17	FC	resolved
El Salvador	Oct-17	FC, LC	resolved
Venezuela	Nov-17	FC	**ongoing**
Barbados	Jun-18	FC	resolved
Barbados	Aug-18	LC	resolved
Argentina	Aug-19	FC, LC	resolved
Argentina	Dec-19	FC	resolved
Argentina	Jan-20	LC	resolved
Lebanon	Mar-20	FC	**ongoing**
Argentina	Apr-20	FC	resolved
Ecuador	Apr-20	FC, LC	resolved
Suriname	Jul-20	FC	resolved
Belize	Aug-20	FC	resolved
Zambia	Oct-20	FC	**ongoing**
Suriname	Nov-20	FC	resolved
Zambia	Jan-21	FC	**ongoing**
Suriname	Mar-21	FC	**ongoing**
Belize	May-21	FC	**ongoing**

Source: S&P, Moody's, IMF, IIF

II. A Short History of the *Principles for Stable Capital Flows and Fair Debt Restructuring*

- *Charles Blitzer*[1]

The *Principles for Stable Capital Flows and Fair Debt Restructuring* (the *Principles*) are voluntary guidelines formulated in 2004 by the Principles Consultative Group—a working group composed of representatives of emerging market borrowers and their official and private creditors—with the IIF acting as the group's secretariat. The *Principles* were endorsed in 2004 by the G20.

The motivation to develop the *Principles* arose out of significant concerns about external financing in emerging markets, stemming from the shift from primarily bank borrowing to primarily bond markets following the debt crisis of the 1980s and the lack of sufficient support for a non-voluntary (i.e., statutory) approach to sovereign debt restructuring.

The primary areas of concern resulting from the structural shift from bank lending to bond financing were:

- **Borrower-creditor communications**: adapting new or improved modes for information dissemination and dialogue between issuers, on the one hand, and the now more numerous holders of emerging market sovereign bonds, on the other. The IIF has continued to play a leading role in monitoring and publicly reporting on investor relations programs at the country level.
- **Collective action problems:** With more dispersed holdings, there were growing concerns about collective action problems whereby holdout creditors would make it more difficult to conclude sovereign bond restructurings. These collective action problems were seen as more serious and potentially disruptive than they had been in the previous bank-financed era.

Gradually, two possible approaches to alleviating these concerns emerged. The so-called **"contractual approach"** focused on the importance of good-faith discussions and negotiations; on data transparency; as well as on collective action clauses (CACs – see Chapter VI) in sovereign bond issues subject to foreign law or which provided for foreign court jurisdiction for enforcement. These provided for supermajorities of bondholders to permit modification of the bonds of the minority who either objected or failed to vote. This approach was broadly supported by private sector financial firms and generally supported by emerging market issuers. The other approach focused on creating some sort of bankruptcy-like framework for certain types of debt. This "**statutory approach**" came largely from academic writings and initially was supported by the NGO community, which had long-standing concerns about over-indebtedness, and by some governments as well.

In late 2001—in the midst of a debt crisis in Argentina—the debate on these approaches intensified after then-IMF First Deputy Managing Director Anne Krueger proposed in some detail a statutory approach that would have involved the IMF as an adjudicating court in applicable sovereign debt restructuring matters. This proposal, known as the Sovereign Debt Restructuring Mechanism (SDRM), gained significant support from some governments, primarily in Western Europe. However, the private financial sector viewed such a regime as deeply flawed and unacceptable. Market participants argued that the holdout problem—the primary rationale for a statutory regime—was not as prevalent or disruptive as characterized. They emphasized that true holdouts wanted a debt exchange to be largely successful, allowing the issuer more resources to pay them. Market participants pointed out that very few financial firms—even hedge funds specializing in distressed sovereign debt—were engaged in true holdout behavior.

[1] Principal, Blitzer Consulting

After some initial hesitation, the U.S. government indicated that it did not support further consideration of the statutory approach. This meant the statutory approach could not be enacted through an amendment of the IMF's Articles of Agreement, and the U.S. instead supported pursuing the contractual approach. In this context, then-Banque de France Governor Jean-Claude Trichet proposed that a **voluntary set of guidelines** be developed through joint discussions between all interested parties. A working group was formed by the IIF that included representatives from private creditors, official creditors and borrowing countries. The IMF was a close observer of this process and commented during the process of drafting the guidelines. Caio Koch-Weser, then the Secretary of State in the German Ministry of Finance, played a leading role in securing the G20's endorsement of the *Principles* in late 2004.

The institutional apparatus for the *Principles* was formed in 2004 and includes the Trustees, the Principles Consultative Group (PCG), and the IIF acting as the Secretariat. The Trustees include present and former senior officials of both issuer and creditor governments and senior representatives from the private sector. They are responsible for approving all policy decisions related the *Principles*.

The PCG also comprises broad-based membership drawn from the private sector and officials from both issuer governments and creditor governments. The PCG meets regularly throughout the year to discuss current economic and financial developments and to discuss the outlook for countries that are either in debt distress or actively pursuing a debt restructuring. The PCG is also a forum to discuss current policy issues related to the *Principles*, for example recent developments such as the G20/Paris Club DSSI and Common Framework, debt transparency initiative and relevant IMF policies. While members of the PCG are free to present their individual perspectives within PCG discussions, the PCG, as a collective, avoids taking sides on the economic and financial substance of proposals in individual sovereign debt restructurings. The PCG also provides sovereigns with best practice recommendations 1) on the formation and operation of creditor committees and 2) investor relations (see for example the 2020 PCG Report). Updates to the governance of the *Principles*—including development of a formal Terms of Reference for both the Group of Trustees and the Principles Consultative Group—are in progress and will be published ahead of the IMF/World Bank Spring Meetings in 2022.

On several occasions since 2004 there has been a need to update or clarify the *Principles* themselves in the context of market developments. In the wake of Eurozone debt crisis and the Greek crisis, the *Principles* were broadened with an addendum in 2012 to clarify that the *Principles* also apply to customs unions and advanced economies, not just to emerging markets and developing countries. As noted above (see Overview, page 3), a working group of the PCG is developing proposals for additional changes to the *Principles* in line with recent market and official sector developments related to the COVID-19 pandemic and to changes in the sovereign debt landscape over the past several years.

III. Work of the PCG and the IIF Committee for Sovereign Risk Management to Convey Private Sector Perspectives and Facilitate Private Sector Participation with respect to the G20/Paris Club Debt Service Suspension Initiative (DSSI) and the Common Framework for Debt Treatments beyond the DSSI

- *Deborah Zandstra*[2] *and James Kelton*[3]

A. Introduction

On 25 March 2020, in response to the COVID-19 pandemic, the World Bank Group (World Bank) and the International Monetary Fund (IMF) issued an exceptional joint call to action calling on all official bilateral creditors of countries eligible for assistance from the International Development Association (IDA), the world's poorest countries, to suspend debt payments from all IDA countries who request forbearance.

B. G20 Communiqué

On 15 April 2020, the G20 Finance Ministers and Central Bank Governors Meeting released a communiqué (April 2020 Communiqué) in which it supported "a time-bound suspension of debt service payments for the poorest countries that request forbearance". The April 2020 Communiqué included a term sheet (G20 Term Sheet) which set out the terms of the Debt Service Suspension Initiative for Poorest Countries (DSSI). The key terms of the DSSI were:

- The DSSI would be available to all IDA countries and all least developed countries (as defined by the United Nations (UN), in each case, which are current on IMF/World Bank debt service and which make a request for forbearance.
- Beneficiary countries would be required to commit to redirect savings to social, health or economic spending in response to the pandemic, disclose all public sector debt and contract no new non-concessional financing during the concession period other than in compliance with applicable IMF/World Bank limits on non-concessional borrowing.
- The cut-off date would be 24 March 2020 so new debt incurred after that date would not be in scope for the DSSI.
- The initiative would last until the end of 2020 and was stated to be also agreed by the Paris Club.

In a subsequent communiqué on 14 October 2020 (October 2020 Communiqué), the G20 extended the DSSI to 30 June 2021. The October 2020 Communiqué also set out that the repayment period for suspended amounts would be five years with a one-year grace period (for a total of six years) and clarified that (i) the debt suspension would apply from the date of application and (ii) beneficiary countries must request the DSSI from all their official bilateral creditors and not only a subset of them.

In a further communiqué on 13 November 2020 (November 2020 Communiqué) the G20 specified the need for creditors and beneficiary countries to "take into consideration the need to avoid bunching effects in the debt service" when bilaterally agreeing repayment schedules for the repayment of arrears after the end of the suspension period. By way of complement to the G20 Term Sheet, it was also clarified that the debt service suspension extends to syndicated loans where official bilateral creditors are participants. The

[2] Partner, Clifford Chance LLP
[3] Associate, Clifford Chance LLP

November 2020 Communiqué also looked ahead and recognized that debt treatment may be required on a case-by-case basis beyond the DSSI and endorsed the Common Framework for Debt Treatments beyond the DSSI, set out in Annex I thereof (**Common Framework**), which was stated to be endorsed by the Paris Club also. The Common Framework is discussed further below.

Most recently, on 7 April 2021 (**April 2021 Communiqué**), the G20 extended the DSSI for a final time to the end of 2021. There is no suggestion that the initiative will be extended further beyond this date.

The list of the countries which, at any time, have requested participation in the DSSI is available here.

In addition to Paris Club members, China, India and Saudi Arabia agreed to take part in the DSSI as official bilateral creditors.

The involvement of private creditors was encouraged by the G20 – this is discussed in further detail below.

C. Involvement of the IIF in the DSSI

The G20, in its April 2020 Communiqué, called on the private sector to participate in the DSSI, on comparable terms, working through the IIF.

Prior to the release of the G20 May 2020 Communiqué, the IIF wrote to the IMF, the World Bank Group, the OECD and the Paris Club and noted that in response to the COVID-19 pandemic and the economic fallout (alongside multilateral concessional financing and official bilateral creditor forbearance), there was a willingness among private sector creditors to forbear payment default for the poorest and most vulnerable countries for a specified period of time, upon the request of a sovereign debtor.

Following the release of the G20 May 2020 Communiqué, the IIF wrote further letters welcoming the DSSI and noting that it had reached out to over 100 lending firms representing close to $45 trillion in assets under management (AUM), and accounting for a significant proportion of the external sovereign debt service of countries in-scope for the DSSI, through two policy working groups – the public-private Principles Consultative Group and the private sector-only Committee on Sovereign Risk Management (CSRM).

The IIF stressed that there was "tremendous appetite among its members to help vulnerable countries with debt service problems" but noted the consensus that there could be no "one size fits all" approach and that the complexity and wide range of creditors, borrowers and financing arrangements necessitates a case-by-case approach, initiated by the borrower country. This conclusion and the private sector discussions which took place by way of support of DSSI led to the publication of the Terms of Reference (a private sector term sheet in respect of potential private sector participation in DSSI on a county by country basis) and other private sector tools by the IIF discussed below.

Although some have questioned why formal participation by private creditors in the DSSI has been limited, it is notable that through the provision of new financing to address liquidity needs, the contribution of private creditors has been significant. We set out in Box 2 a summary of some of the context for the private creditors' response.

D. IIF Terms of Reference

In May 2020 the IIF published the Terms of Reference for Voluntary Private Sector Participation in the G20/Paris Club DSSI with the intention that they "be used as a starting point to advance individual conversations between sovereign borrowers and their private creditors". The Terms of Reference, set out

the broad intention and scope of private creditor involvement in the DSSI as well as a basic framework for how the DSSI could be executed between sovereign borrowers and private creditors, recognizing that each situation will be bespoke, requiring unique solutions, but also with a sharp focus on the "vital principle of non-discriminatory treatment of all creditors".

On 3 December 2020 the IIF published an addendum to the Terms of Reference which (i) extended the debt service suspension to June 2021 in line with the G20's October 2020 Communiqué and (ii) clarified that arrears should only be repaid after the end of the suspension period in a way that avoids bunching of debt repayments in line with the G20's November 2020 Communiqué.

E. G20 DSSI Template Waiver Letter Agreement published by the IIF

In June 2020, due to a concern raised by the IIF and the CSRM that engaging with the DSSI, even with official creditors only, could trigger certain events of default in the finance documents of sovereign borrowers, the United Nations Economic Commission for Africa (UNECA) requested that the IIF develop a template waiver which countries could tailor and send to their private creditors when requesting forbearance from official creditors to avoid unintentionally triggering a wave of events of default and cross-default. The Template Waiver Agreement was published by the IIF in July 2020 to be used in connection with bilateral and syndicated loan arrangements. The template waives events of default which may arise from discussions with the official sector, any agreement with the official sector and any announcement of an intention to participate in the official sector DSSI. The IIF noted in its July 2020 Update that "while the legal documentation underlying the relevant debt arrangements make a "blanket" waiver unachievable, our CSRM members are supportive of the concept of a waiver".

F. The Term Sheet in Respect of a Framework Agreement for Loan Debt

On 3 December 2020, following discussions with IMF shift into the possibility for a mechanism to deal with loan debt in an aggregated manner, the IIF published an addition to its toolkit: summary terms for a voluntary debt service suspension framework agreement for non-bonded debt (Framework Term Sheet). The Framework Term Sheet was created in response to concerns that it may be difficult for participating countries with several loans made by multiple private creditors to ensure that all such creditors amend their loan agreements on the same terms. The Framework Term Sheet provides a "streamlined, market-based approach for amending contracts while addressing concerns about breaches of contract and cross-default risks". The Framework Term Sheet was designed so that a debtor country would have a single framework agreement with a deed of adherence per debt arrangement setting out the revised payment schedule for that debt arrangement. The Framework Term Sheet acknowledges the need for a case-by-case approach, providing a simple guide to aid parties in their discussions and a template which can be tailored as necessary to the facts of each situation.

G. The Technical Note on Consent Solicitations

In response to concerns that there had been greater focus on bank lending and insufficient focus on bonded debt and following on from the determination that a case-by-case approach was unavoidable, on 3 December 2020 the IIF published a technical note on consent solicitations designed to give sovereign issuers an outline of the considerations to be taken into account prior to embarking on a process of soliciting the consent of bondholders to suspend debt service on DSSI terms (Technical Note).

It has been encouraging to see the international community rally in support of the world's poorest countries and to date over 45 countries of the 73 which are eligible have taken up the initiative with official bilateral

creditors. Whilst the involvement of private creditors in private sector DSSI has been limited private creditors engaged significantly with official sector representatives and debtors on DSSI scoping and implementation and brought considerable technical and market expertise to that engagement.

H. The Common Framework

Whilst there is a general acceptance that the official sector DSSI was a welcomed and timely response by official bilateral creditors to the COVID-19 pandemic, as the months passed from April 2020, there were reflections as to whether extensions of debt service would continue to represent the best approach. There is no doubt that many eligible countries are a long way from recovering from the effects of the pandemic. In this light, it was recognized that the DSSI did not address medium term debt distress situations that are appropriately addressed in in conjunction with an IMF program. Despite the private sector's extensive engagement on DSSI, the official sector continued to express concerns regarding lack of private sector involvement in the specific modality envisioned by the official sector architects of the DSSI. By the November 2020 Communiqué, this had given rise to the Common Framework for Debt Treatments beyond the DSSI. In many respects this represents a return to more conventional approaches to sovereign debt treatments. Attention has now shifted to the Common Framework as it is likely to provide more durable treatments for dealing with debt relief for the DSSI-eligible countries, where warranted.

Under the Common Framework, as with the DSSI, the process must be initiated by the debtor country. However, unlike the DSSI, the debtor country must receive financing through an IMF arrangement, with the IMF-WBG conducting a debt sustainability analysis (DSA) that informs the Common Framework debt treatment and restructuring. The key parameters under the Common Framework include: changes in nominal debt service during the IMF Program period; debt reduction in NPV terms, where applicable; extension of the duration of the treated claims (re-profiling). Debt write-offs are contemplated 'in the most difficult cases'. The key parameters of a particular debt treatment will be recorded in a Memorandum of Understanding (MOU) which is signed by all participating official bilateral creditors and the debtor country and is implemented through legally binding bilateral agreements.

Another key difference between the DSSI and the Common Framework is the principle of comparability of treatment under the Common Framework. The legally binding bilateral agreements will include an obligation requiring the debtor country to obtain from all other official bilateral and private creditors a debt treatment at least as favourable as that agreed in the bilateral agreement. We have set out a comparison of the DSSI and the Common Framework in Table 2.

Chad, Ethiopia and Zambia have so far made a request for treatment under the Common Framework. The private sector has requested greater transparency on the implementation of the Common Framework both in terms of content and process and continued engagement with the private sector by the G20 and Paris Club.

The IMF/World Bank have made public a Q & A on the DSSI and Common Framework, which is accessible here.

Table 2: Significant differences between the DSSI and the Common Framework

DSSI	Common Framework
Available for a set period	No set period
Notion of private creditor “comparable” terms	Principle of private creditor “comparability of treatment”
Not dependent on DSA	Dependent DSA and financing assurances analysis
Liquidity support	Liquidity or solvency support
Extent of debt service suspension agreed	Extend of debt service suspension agreed on a case-by-case basis

Source: IIF

Box 2. The Private Sector and the DSSI

The April 2020 G20 Finance Ministers and Central Bank Governors Communiqué' called on the private sector to participate in the G20/Paris Club Debt Service Suspension Initiative (DSSI) "on comparable terms" to those set out for official sector bilateral creditors. Over the subsequent months, the Institute of International Finance (IIF) worked closely with private creditors representing over $40 trillion in assets under management, via both the Principles Consulting Group (PCG) and the IIF Committee for Sovereign Risk Management (CSRM) to facilitate private sector participation. While the resulting Terms of Reference and toolkit provided a robust framework for engagement, there have been no formal requests from sovereign borrowers for debt service suspension from their private creditors in respect of bonded debt (though there have been a few requests in respect of non-bonded debt). This box provides an overview of the constraints on private sector participation in the DSSI, and the different ways in which the private sector has participated in providing liquidity to DSSI-eligible countries.

Limited Commercial Debt. Of the 73 countries eligible for the DSSI, only 22 had outstanding Eurobonds and fewer than 50% had any private sector commercial debt at all. This means that private sector involvement could not reach the level of involvement by the MFIs and official bilateral creditors. Since the onset of the COVID-19 crisis, DSSI-eligible countries have raised more than $22 billion from international bond markets. This overall amount of new financing is substantially larger than the temporary relief provided by the DSSI since it took effect on May 1, 2020, which, according to the World Bank in late September 2021, stood at some $5 billion.[4] Moreover, during the same period, cross-border commercial banking flows into DSSI-eligible countries amounted to over $10 billion. In this capacity, private creditors have made a significant contribution to the liquidity needs of DSSI-eligible countries during the relevant period.

Potential for Triggering Defaults. When the DSSI was launched there was widespread private sector concern that eligible countries could inadvertently trigger events of default and cross-default in existing finance documents by requesting participation in the DSSI with official bilateral creditors unless they obtained a waiver from each of their creditors. The IIF attempted to address this concern by publishing the Template Waiver Agreement discussed above. This concern showed that even an initiative proposed and implemented at the supra-national level such as the DSSI could not overcome the need for individual case-by-case implementation. The need for a rapid response to a crisis came up against contractual limitations on the relevant countries, which could only be addressed individually.

Need to Retain Market Access. A concern repeatedly expressed by private creditors, particularly regarding eligible countries which currently access the international capital markets, was that participation in the DSSI could impact such countries' ability to do so going forward at rates which are not prohibitively expensive. The IIF noted that "debt service obligations to private creditors tend to be concentrated in a subset of DSSI-eligible countries with market access"[5]. A particular concern was that a country being locked out of the capital markets could transform a liquidity crisis into a solvency crisis at a time when significant private sector financing would be needed by eligible countries—including

[4] https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative

[5] The IIF estimated that $12.6 billion of the $30 billion in debt service payments from in-scope countries due May-December 2020 was due to private creditors. Of the in-scope countries that do have bonds outstanding, the IIF estimated that around $5 billion was due on these bonds between May-December 2020.

financing required in order to meet the UN Sustainable Development Goals (SDGs).

Different Definitions of Net Present Value (NPV) Neutrality. The G20 Term Sheet stated that "the suspension of payments will be NPV neutral" i.e. payments would be deferred not cancelled and the overall impact on the creditor would be neutral (assuming no subsequent event of default). The concern of the private sector was that NPV-neutrality has a different meaning for public and private creditors and forbearance on its own is NPV-negative. Achieving NPV-neutrality would require either higher accrual rates on suspended debt or alternative credit enhancements.

Concern about a Credit Rating Downgrade. Related to points two and three above, the concern arose that failure to achieve NPV-neutrality when implementing the DSSI would lead to ratings downgrades (see Chapter VII). Following discussions with major rating agencies the IIF concluded that "it is virtually impossible to avoid downgrades and credit rating agency-designated default ratings (which stem from net present value losses) without an additional economic component, an improvement in bond covenants or other incentives/credit enhancements". Ratings downgrades (or the assignment of selective default ratings) would likely freeze the relevant country out of capital markets, which could be hugely detrimental to that country's long-term development. DSSI eligible countries with market access therefore decided not to seek private sector DSSI.

Lack of Transparency. This concern can be sub-divided into two areas: (i) publication of information on requests for debt service suspension was needed; and (ii) the redirection of funds freed up by DSSI needed to be directed towards COVID-19 relief as required by the G20 Term Sheet. This would need to be monitored, which cannot be done by private sector creditors. In its July 2020 Update, the IIF noted that some respondents to a survey it conducted "expressed concern about how the DSSI is being implemented, including with respect to lack of data transparency especially on debt and debt service projections".

Lack of Requests from Sovereign Debtors. A request for forbearance from a DSSI-eligible country is a condition for application of the DSSI to private creditors. Very few countries made such a request (and none in respect of bonded debt). Reasons for the lack of requests may have varied but from general discussions between debtors and creditors on DSSI implementation key factors appeared to be: ratings concerns, concerns around pricing implications for future debt issuances and loss of market access, relative modest debt servicing costs benefits as compared to cross default risk and implementation risk. Nevertheless, the IIF hosted many discussions with the G20, IMF, Paris Club and private sector members to create a tool kit to facilitate private sector involvement should it be required by eligible sovereign debtors.

IV. Creditor Committees and Sovereign Debt Restructuring

- *Yannis Manuelides*[6] *and Mark Walker*[7]

This chapter sets forth views of the role, functioning and effectiveness of creditor committees in sovereign debt restructurings from Mexico in 1982 to date. The views are based on the authors' experience and are intended to generate further discussion on an increasingly relevant and complex subject.

A. Bank Debt

Beginning with Mexico's declaration in August 1982 that it was unable to continue to service its sovereign debt and continuing past the Brady Bond era (also ushered in by Mexico in 1990), Mexico, Chile, Argentina, the Philippines, Yugoslavia, Slovenia, Venezuela, Côte d'Ivoire, the Republic of Congo, South Korea, Indonesia and other countries with significant public sector debt owed to commercial banks around the world negotiated amendments to their bank credit agreements to extend payment terms, modify interest rates, add guarantees and arrange concerted new financings. In each case, the counterparty to the sovereign debtor was a committee of bank creditors, often styled a bank advisory group or committee.[8] These committees described their role as acting as a communications link between the debtor country and the international banking community.

For large debtors, the committee comprised a cross section of 10-15 bank lenders from the United States, Europe, and often Japan. For smaller African borrowers, whose restructurings took place later in the cycle after debt had in many cases traded out of the hands of the original bank lenders, the committees tended to be smaller and included distress funds, as well as original bank lenders.

Many large banks with sovereign exposure, including Citibank, Chase Manhattan, JP Morgan, Deutsche Bank, Swiss Bank, BNP, Société Générale, and Bank of Tokyo, sat on multiple committees, often with the same representatives. Citibank alone chaired numerous committees and a small number of law firms acted as advisors to debtors and creditor committees. Thus, there developed a shared understanding among a relatively small group of professionals and a convergence around accepted market practices that facilitated agreement. In a few cases where the initial committee composition included or was led by institutions that lacked the shared experience of "regular members", the debtor intervened to encourage a change in the composition of the committee acceptable to the majority of its members.

For the larger debtors, the creditor committees appointed economic subcommittees staffed by senior bank economists. These subcommittees held separate meetings with government economists to discuss the debtor's economic program and the relief sought by the debtor. The subcommittees, as well as committee members generally, also met from time to time with representatives of the IMF and other official and bilateral creditors, including in the case of systemically important debtors, the US monetary authorities, and in the case of francophone Africa, the French monetary authorities.

In the case of bank loan agreements, the full committee and the debtor (accompanied by their legal advisors) negotiated first the principal economic and legal terms of the restructuring, followed by the restructuring agreement itself. It was common for the IMF to have one or two representatives sit through many of the meetings between the debtor and the committee, partly to be kept informed, partly to act as a resource and

[6] Partner, *Allen & Overy LLP*
[7] Senior Managing Director, *Guggenheim Securities LLC*
[8] Bank advisory committees became known as the London Club even though they met in New York, Frankfurt, Paris and elsewhere as well as in London.

partly to support the economic program agreed with them.

The committees worked on the basis of unanimity, ironing out differences among themselves, but that operating principle meant that debtor countries were offered the lowest common denominator as it were, subject to negotiations that shifted people's views and a desire to reach a deal. To the knowledge of PCG members, there was only one case where unanimity became an issue—one bank member of Slovenia' s creditor committee objected to a key financial term accepted by all of the other banks and the deal (the assumption by Slovenia of a portion of the debt of former Yugoslavia) was put on hold for many months during which Slovenia made payments into a segregated account as a sign of good faith.

In addition to negotiating the terms of the restructuring and the related documentation, the bank creditor committees played an important role in encouraging other creditors to approve the deal they negotiated. The practice that developed and was uniformly followed was not only for committee members to reach out to other banks during the negotiating process, but also, once a deal had been struck, to issue a statement committing to participate in the deal themselves and to join road shows and help sell the deal.

It was accepted practice for the debtor to pay the fees of legal counsel to the creditor committee. To the knowledge of PCG members, none of the bank committees engaged financial advisors (the financial advisory work being conducted by the banks and their economic subcommittees), although, in rare cases, the debtor agreed to pay a fee to the committee chair.

On balance, it is fair to say that the committee process worked well in that agreements were struck that attracted a very high degree of support, with few holdouts and very little litigation[9]. Initially the process was painfully slow with negotiations extending over many months. In fairness, the issues were new and, in the absence of market practice and with no applicable legislative insolvency regime, consensus was often slow in forming. Involving a significantly larger group of creditors in the detailed document negotiation than would have been involved when the loan was first structured and marketed undoubtedly helped in reaching a satisfactory result, even as it added to the time required to reach consensus. By the time of the Asian financial crisis in 1998, familiarity with the negotiating process and a shared consensus as to the treatment of many issues that had once been new, enabled South Korea and Indonesia to negotiate and close the restructuring of the external debt of their banking systems in just a few months.

B. Sovereign Bonds

Before Mexico's Brady exchange virtually all sovereign debt consisted of bank loans. The outstanding volume of sovereign bonds was so low that they were routinely excluded from restructuring. Today the vast majority of unsecured sovereign debt is in the form of bonds.

Whereas banks sit with their debtor and negotiate changes in loan terms, the market practice for amending publicly traded bonds is an exchange offer whereby bondholders are invited to exchange their bonds for new instruments. Before launching an exchange offer, a wise and well-advised debtor will carry out sufficient consultation with its bondholders to be assured that its offer will succeed. And the accepted, but not the only, means of conducting that consultation is to solicit the formation of a bondholder committee

[9] From time to time a bank with relatively small exposure would resist the efforts of the debtor and the bank advisory committee to persuade it to join a restructuring and insist on payment in full under threat of litigation. In most cases the added persuasive efforts of a bank regulator tipped the scales in favor of participation in the restructuring; occasionally, if the timing was right, holding out proved a successful tactic, and the bank was quietly paid off.

and sit down with it to discuss and agree the new terms to be offered to the market. [10]

As an alternative to the appointment of a committee, some debtors (in the private as well as the public sector) rely on the advice of their dealer managers who alone, or in conjunction with the debtor itself, will informally consult other market participants to gauge potential support for a proposed exchange offer. This approach of debtor consultation is likely to produce a less reliable read of the market than engaging with a well-formed committee. The dealer managers owe a duty to the debtor and not to the bondholders and, as a result, the voice of the bondholders will be muted, which may result in a misreading of the market, except perhaps in the easiest of cases. [11]

Good and bad reasons as to why a debtor may seek to bypass a committee include: an effort to avoid the expense of paying legal and, perhaps, financial advisors to a committee; a belief that *a* committee or, if already formed at the insistence of the creditors, *the* committee will push the debtor to accept less favorable terms than it believes will be acceptable to a sufficient number of bondholders to achieve the desired result; or a decision to present holders with a "take-it-or-leave-it" offer with default being the alternative to acceptance of the deal.

The composition of a bondholder committee raises issues that are largely absent or easily overcome in the case of bank debt, where, with few exceptions, the creditors are known to the debtor, trading activity is small and, at least the lead bank, will have directly negotiated the original terms with the debtor. The ideal committee will consist of bondholders who are skilled and knowledgeable, experienced in restructuring and willing to engage in a constructive process that respects the real constraints faced by their debtor as well as their interests and the interests of all affected creditors more broadly. The committee should have the market knowledge and influence, together with weight of their own holdings to contribute materially to the success of the offer.

What is the ideal composition of a bondholder committee and what makes it "representative"? There is no magic formula to determine the ideal composition of a bondholder committee. The task can be challenging, particularly in the case of a distressed debtor whose bondholders are likely to consist of a mix of holders who acquired bonds at par and those who bought at depressed prices. One might be tempted to think that the larger the committee the better, as a larger committee will presumably be more "representative". A large committee may discover, however, that it needs the acquiescence of one or more holders who lock themselves into extreme positions that are unacceptable to the debtor. A smaller, seemingly less "representative" committee which has most of the features described in the preceding paragraph is more likely to be "representative" of bondholders and to serve the interests of the debtor and its creditors.

There is an important difference between bank loans and bonds that is also pertinent to the role of a creditor committee. Loan agreements have a well-developed mechanism for collective action decisions. Typically, the collective action clauses (CACs) of loan agreements do not allow the modification of key terms

[10] The International Capital Markets Association (ICMA) has developed model creditor engagement clauses. Under certain circumstances (including the actual or potential occurrence of any of the stipulated events of default and the announced intention of the sovereign issuer to seek a restructuring of any of its debt) these clauses would allow holders of 25% of a bond issue to form a committee (without the issuer's consent or input into the composition of the committee) to negotiate with the issuer or discuss with other creditors and to appoint financial and legal advisors at the issuer's expense.

[11] When Mexico's President Lopez Obrador cancelled the new airport whose construction had been started by his predecessor, Mexico was required to amend the terms of the bonds issued to finance the new airport. Instead of inviting bondholders to form a committee, Mexico relied on its deal managers to advise as to terms that would be acceptable to the market. This approach proved both inadequate and embarrassing as Mexico was required to amend its offer two or three times before it was able to exchange an acceptable portion of its outstanding bonds.

(including repayment amounts, interest rate and payment dates) without the unanimous consent of the lenders (or very close to it). The corresponding threshold in bonds, however, is typically a 75+% majority, which enables sovereign issuers to modify the key financial terms of their bonds with substantially less than unanimous consent. Moreover, bank loans do not have the equivalent of aggregated bond CACs that operate across more than one series of bonds. So, there is a certain logic (even if not dispositive) to a bank committee operating by unanimous consent. The same is not true of a bondholder committee where, by definition, CACs represent a rejection of the notion of unanimous consent. Consequently, the debtor's burden in deciding both what level of committee approval provides reasonable comfort that the exchange offer will succeed and what is required of it to evidence adherence to a reasonable standard of good faith should not be tethered to a requirement of unanimous committee consent to its proposed exchange offer terms.

By definition, a restructuring is an effort by the debtor to modify the terms of a presumably enforceable agreement to repay money borrowed. Where the official sector, and the IMF in particular as the lender of last resort, act in support of this effort they understandably will want to ensure that the debtor engages in good faith negotiations with its creditors based on its real needs and a well- designed economic and financing program that the official sector is willing to support. [12] Good faith negotiations with a well-designed creditor committee are in most cases the best way to meet this objective.

C. Multiple Committees

As the universe of bondholders has expanded, we have recently seen the formation of competing committees seeking to negotiate independently with a single debtor. The most common justification for multiple committees is the real or perceived differentiation of interests between groups of creditors.

Where creditors who are broadly the same (e.g. holders of senior unsecured bonds and loans) form multiple committees there is a high risk that they will compete to outdo one another, exacerbate the issue of descent to the lowest common denominator, and may even raise questions of good faith on the creditor side.

Multiple committees also exacerbate the challenges of the debtor who will often have capacity issues in any event. There is no good way for a debtor to conduct separate negotiations with two competing committees purporting to represent the same universe of creditors. Indeed, the very notion is antithetical to the concept of the debtor engaging with a "representative" committee.

A single committee of senior unsecured creditors does not preclude the formation of groupings within the committee to consider issues which are unique to them. It is the view of the authors that if "orderly debt restructuring" is the goal, then this is not best promoted by a multiplicity of committees of creditors whose debt is in essence the same.

One has to accept however, that there may be exceptional circumstances where the formation of groupings within a single committee will not be possible, notwithstanding the similarity in the nature of the fundamental debt claims. Where these circumstances lead to the formation of multiple creditor committees, a steering group, a super-creditor committee should be established to ensure that it unifies what might otherwise be conflicting and self-defeating approaches to the resolution of debt claims which are fundamentally the same.

[12] Indeed, the IMF will, if the debtor has defaulted in its payment to its external private creditors, be prepared to lend while these arrears are outstanding on the condition, inter alia, that the debtor is engaged in good faith efforts to reach a collaborative agreement with the relevant creditors. If the debtor is not in arrears, then such requirement for good faith engagement does not form part of the IMF's officially stated policy.

Where competing committees represent different series of bonds with different terms, including different CACs, the situation is significantly more complex. The issues raised here go well beyond the role of creditor committees. To the extent the differences between series relate to interest rate, tenor or other financial terms there is no apparent need to create multiple committees, and indeed good reason to insist on common treatment. To the extent, on the other hand, the differences relate to perceived differences in bargaining power between different series as a result, for example, of different voting requirements under difference CAC formulations, a question of a different order is posed. This update identifies but does not seek to resolve this question.

D. Bonds and Other Unsecured Claims

A multiplicity of unsecured creditors of equal ranking ranging from commercial creditors to a panoply of claimants with arbitration awards and judgments (e.g. Venezuela), each group armed with arguments as to why its claims should be preferred, relegates a bondholder committee to but one place in the chorus line. Financial claims are not inherently senior or junior to other claims, and a restructuring that leaves a material portion of outstanding liabilities of the debtor unresolved may not work. Should creditors seek to form a broad inclusive committee that includes all claimants of the same class? Or are multiple committees the answer in these circumstances, with each category of claimants going it alone, even if in the end they should receive comparable treatment, as for example the Common Framework suggests?

As a practical matter, there may be sound reasons as to why a debtor may feel that it should not treat all *pari passu* claims alike. Trying to dispose of or settle one homogenous set of claims may not be a bad idea at some point, and in fact may be the only feasible solution. In these circumstances should a bondholder committee align itself with or open itself to the participation of other creditors of similar standing? What should the obligations of the debtor be in this case and what must it do to demonstrate a good faith effort to resolve claims against it? These are difficult questions, for the most part unaddressed and unanswered to date. That said, when the situation is viewed in all its complexity, to say that the debtor must negotiate with a bondholder committee and only approach creditors with an offer approved by that committee seems simplistic in these circumstances. In the end, different creditors may receive comparable treatment in financial terms through disparate solutions that meet their diverse needs. Encouraging the debtor to interact separately with different creditor groups may be the best way to identify and implement the disparate but comparable solutions, which is what sophisticated debtors do today. By the same token, by working together (whether through a single committee or otherwise) creditors may help arrive at a solution acceptable to all creditors and improve their bargaining power as well.

E. Debtor's Role in Committee Formation

Giving the debtor a role in selecting or approving membership on creditor committees (which Indonesia, South Korea and Mexico did to good effect at one time or another) is an idea that should be considered. It may well contribute materially to the committee's "representativeness." At the very least, it will strengthen both the argument and the prospect that the debtor should and will engage meaningfully with the committee.[13] After all, the debtor has a keen interest in maintaining good relations with investors, not just to secure a good restructuring outcome, but also to assure future capital flows.

[13] In the early stage of the Greek restructuring in 2011-12, before the creditor committee expanded its membership considerably, it "instructed" Greece and its advisors that they were to deal only with the committee and should not talk to other creditors. This admonition was ignored.

F. Creditor Committees' Costs

Creditor committees will almost always need to engage financial and legal advisors to assist them. The costs of such engagement can be as considerable as they are necessary as today's fund managers have the assistance of neither large legal departments nor of appropriate teams of economic analysts. Committee members will not want to bear these costs themselves. Some committee members, especially mainstream fund managers, will not have the funds to pay for these costs even on a bridging basis. At the same time, debtors may not be in a position to indemnify creditor committees for such costs without express authorization, and such authorization may not be forthcoming. As noted earlier, in historic bank led restructurings the debtor indemnified the creditor committee for the costs of its legal counsel (financial advisory services being rendered in-house). The practice almost certainly depended on the existence of contractual provisions to that effect in the loan documents. This settled the question of obligation and of authorization for the debtor, or at least made for a very powerful argument for the creditor. In today's bond financing, issuers will not volunteer such cost indemnity provisions in their bond documents unless there is an absolute requirement for such provisions by the market when the bonds are issued. In the absence of such requirement creditor committees find themselves at a disadvantage in retaining appropriate advisors. This may adversely affect the speed and quality of the negotiations and ultimate resolution agreed. A meaningful engagement based on good faith should include a cover by the debtor of properly incurred costs by recognized creditor committees.

V. Reconciling Differences between the *Principles* and IMF Policies

- *Thomas Laryea*[14]

This chapter focuses on the differences between the Principles *and IMF policies and highlights private sector views on ways to increase alignment between the two. Better alignment between the* Principles *and IMF policies should in turn support ongoing efforts to strengthen the international financial architecture.*

The *Principles* and IMF ("Fund") lending policies are complementary components of the international financial architecture for sovereign financing and debt restructuring. The Fund itself has recognized that the *Principles* are broadly consistent with Fund policy expectations.[15] This conclusion is not surprising since the *Principles* have been broadly supported by the G20, whose membership constitutes a decision-making majority within the Fund. Some differences between the *Principles* and Fund policies essentially reflect details in the *Principles*—which are a non-binding and voluntary set of objectives that derive from market-oriented views on best practices—compared to the broad constructs of Fund policy that derive from the Fund's surveillance and lending mandates, have been adopted by the IMF and guide its lending decisions.[16]

The pending parallel reviews of the *Principles* and relevant Fund policy present a timely opportunity to strengthen their core alignment, while explaining the aspects where differences in emphasis are warranted.

- **Engagement with creditor committees**. Market participants hope that the current review of the Fund's policy on Lending into Arrears to Private Creditors (LIA) will result in a closer alignment with the *Principles* regarding the expectation of a sovereign debtor's engagement with a timely-formed creditor committee (without the qualification in the Fund's LIA policy that limited such an expectation to so-called "complex cases" – see Box 3).[17]

- **Resumption of partial debt service**. The *Principles* are nuanced in articulating that this consideration is "to the extent feasible" (which includes economic feasibility), as a sign of "good faith", but not as a distinct precept. The pending review of the *Principles* provides an opportunity for further specification to clarify the extent to which perceived differences with the expectations of Fund's LIA policy on this aspect may be material.

- **Input of private creditors in the Fund's debt sustainability analysis**. While it is recognized that the Fund's mandate requires it to exercise its judgment on the DSA, the Fund's DSA

[14] Of Counsel, *Orrick, Herrington & Sutcliffe LLP*

[15] See, Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework, p. 39, April 26, 2013.

[16] For example, limitations of the Fund's mandate preclude it from involvement in the details of the negotiation between a debtor and creditor and accordingly the Fund has recognized that "when the Principles were drafted, the Fund left their specifics to sovereign debtors and their creditors, since the effectiveness of voluntary rules hinges critically on the negotiation among the parties involved." Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework, p. 39, April 26, 2013.

[17] An important detail with regard to engagement with creditor committees that is not currently reflected in Fund policy is the established practice of the debtor paying the reasonable fees and expenses of the creditor committee, including those of the committee's legal and financial advisors. The ex-ante commitment of the debtor to pay such fees/expenses is justified: (i) to avoid delay in the formation and operation of creditor committees and (ii) to preserve inter-creditor equity (otherwise the creditors participating in the committee could receive a lesser net recovery than the others who would be free-riding on the committee's efforts). To the extent that the Fund decides not to make the debtor's payment of creditor committee fees/expenses an explicit part of the Fund's test for good faith engagement, the Fund could nonetheless encourage the adherence of this practice, in a similar manner to the Fund's encouragement of the adoption of collective action clauses. See IIF Best Practices for Formation and operation of Creditor Committees—Annex VII.

has significant consequences for stakeholders in the debt restructuring process (and even outside of a restructuring context, the Fund's DSA informs assessment of credit risk relevant to financing costs). There are aspects of the Fund's DSA, such as the assumptions on the terms and pace of market access, in which the input of market participants is clearly warranted given their closer proximity to the issue. Furthermore, in line with the initiatives to support greater transparency in sovereign financing and debt restructuring, the call for more structured opportunities for the Fund to receive input from market participants in the context of the DSA is appropriate. These are critically important issues in which the IIF and its members have been encouraging the Fund to reflect on in its review of its LIA policy.

- **Inter-creditor equity**. While the concept of inter-creditor equity has broad acceptance, it is also recognized that the application of this concept and its exceptions can vary across given cases. The rationales for potential differentiation of treatment in order for the debtor to maintain market access, maintain trade lines or safeguard financial stability are well understood and can be addressed on a case-by-case basis. However, many private creditors would appreciate further clarification on the formulation of some areas of Fund policy as it pertains to inter-creditor equity.

While the above-noted differences in emphasis and detail are for the most part explicable in light of the difference in scope and function of the *Principles* compared to Fund policy, the IIF intends to continue to seek to narrow or explain such differences in the pending update of the *Principles*. This exercise should facilitate endorsement of the revised Principles by the G20 and the Fund.

Box 3. IMF Lending into Private Arrears Policy and Pre-default Restructurings

The IMF is currently reviewing its policy for Lending into Arrears (LIA policy) which applies to the IMF's lending into sovereign arrears to external private creditors. This box sets out suggestions from market participants for what might be considered in this review process.

The current LIA policy emanates from 1989 and was last updated in 2002. Prior to 1989, the IMF had a general policy of not lending to member countries that had arrears to official and external private creditors. That policy of "non-toleration of arrears" reflected the understanding that arrears were harmful to the international credit and trade systems and thus were a destructive way for countries to address their economic imbalances. During the 1980s Latin American debt crisis, the application of the Fund's non-toleration of arrears policy raised the concern that private creditors had effectively attained a veto over the Fund's lending. Consequently, the policy was modified in 1989 to allow the Fund to lend on certain conditions before the member country had agreed restructuring terms that would clear the arrears with external private creditors.

The LIA policy, as established in 1989, explicitly applied to bank creditors. In 1998, the policy was modified to apply to external private creditors more generally, including to international holders of sovereign bonds. In 2002, the LIA policy was further modified to clarify the procedural elements of the debtor country's good faith efforts to reach a collaborative agreement with external private creditors.

The IIF's outreach to market participants and informal discussions with IMF staff (as part of the LIA policy review outreach) indicates a number of areas of interest in potential amendments to the LIA policy, including:

Clarifying good faith criterion. A focus on *relevant* information sharing could replace the current distinction between confidential and non-confidential information sharing. Also, the Fund could seek to align expected "good faith" disclosure by the debtor under LIA with other Fund initiatives on debt transparency and with the terms of the Fund's Lending into Official Arrears (LIOA) policy.

Engagement with creditor committees: Clarification would be useful of the circumstances in which debtor negotiation with a creditor committee is expected in accordance with the good faith criterion. As the LIA policy currently stands, the policy distinguishes between so-called "complex cases," in which there is "an expectation that the member would enter into good faith negotiations" with a representative creditor committee formed on a timely basis, and other cases in which the borrower "would be expected to engage creditors through a less structured dialogue."[18] There is widespread support among private creditors for a good faith criterion that expects borrowers to negotiate with representative creditor committees in all restructurings, regardless of complexity.

Creditor committee representativeness. Additional guidance on the factors to be considered in applying the test of representativeness is warranted. Quantitative metrics in terms of the size of the holdings of the creditors in the committee should not be dispositive in all cases:

- Committees sometimes can provide credible assurances that they have support from other

[18] *The Acting Chair's Summing Up-Fund Policy on Lending into Arrears to Private Creditors-Further Consideration of the Good Faith Criterion, Executive Board Meeting 02/92, September 4, 2002 – Selected Decisions and Selected Documents of the IMF, Fortieth Issue*

creditors, beyond its nucleus group. Inclusion of a broader, ad hoc group is sometimes reflected in the sharing of expenses with the steering committees.

- Sometimes a larger committee with close to a blocking minority could be pursuing a non-constructive strategy, whereas there could be a smaller committee trying to work out a solution that would ultimately attract the broadest creditor support.
- In any case, the constitution of a representative creditor committee need not preclude all forms of dialogue with other creditors, particularly where such dialogue is consistent with regular investor relations programs of debt management offices.

Creditor committee fees: Private creditors would welcome language from the Fund encouraging debtors to pay creditor committee fees where there is an efficiency argument for doing so. Such language could recommend the use of a broad template on how to structure fees, particularly given that uncertainty around fees delays restructuring processes and may compromise inter-creditor equity.

Transparency: While information sharing is captured under the existing good faith expectations in Fund LIA policy, there appears to be appetite among private creditors for the Fund to make the expectation of the debtor to disclose disaggregated debt stock still more explicit, although such disclosure may only be possible subject to confidentiality provisions (See Box 4). Private creditors would favor a broader approach to transparency that would include not only access to information on debt stock but also to timelines and processes of the proposed debt restructuring. Of note, the need for greater public sector debt transparency (from sovereign borrowers as well as official creditors) is clearly set out in the preamble to the private sector-focused Voluntary Principles for Debt Transparency (See Box 6).

Pre-default restructurings: Market participants see merit codifying current practice regarding the process expectations for pre-default restructuring cases, informed by the Fund's Financing Assurances Policy. There is also support for including an additional expectation that the borrower should share relevant information with creditors. The current practice regarding pre-default restructuring cases applies to cases where arrears have not occurred in a legal sense, even if the Fund considers the debt to be unsustainable. However, private creditors have noted that these so-called pre-default restructurings in distressed situations may involve default events from a credit-ratings perspective (see Chapter VII).

Box 4. Recent Updates on IMF Debt Limits Policy

Among the plethora of official sector transparency initiatives, the IMF's Debt Limits Policy (DLP) plays a crucial role in many respects, including through its recent introduction of new public debt disclosure requirements for its members. Dating back to the 1960s, the DLP provides the framework for establishing quantitative debt conditionality in the context of addressing public debt vulnerabilities in IMF programs. Fiscal conditionality is generally the most powerful tool in managing public debt vulnerabilities, as broad measures of the fiscal balance can fully reveal debt accumulation, while debt conditionality calibrated and designed in accordance with vulnerabilities identified in DSAs often serves as an important complement and additional safeguard. Both debt and fiscal conditionality require adequate disclosure of relevant debt and fiscal data and, in many countries, improvements in debt transparency (See Box 7).

A recent guidance note[19] on the 2020 DLP reform provides a new, standardized debt holder profile table that the Fund will require country authorities to fill for all program requests and reviews. The table includes granular categories of information on public debt and debt service composition by creditors and instruments. Key components include:

- **Debt stock coverage.** Public debt stock should be broken down into external and domestic, and also by subcategories of instruments and creditors, in U.S. dollars, as a percentage of GDP, and as a percentage of total debt. Coverage should be as broad as in the DSA, although if information for specific sectors (e.g. SOEs) is unavailable an explanatory footnote should be appended to the table.
- **Creditor composition.** The DLP requires a breakdown of external debt by groups and sub-groups of creditors: multilateral, bilateral (Paris Club, non-Paris Club), bonds, commercial, and other international, and also include a list of the two largest creditors within each sub-group and any creditors holding more than 5 percent of total debt. Beyond these requirements, disclosure of information pertaining to creditors is "encouraged but not required."
- **Debt service.** The debt service profile by creditor sub-group over the past three years is required, and further granular information on debt service to individual creditors is also encouraged but not required.
- **Collateralized debt.** The table also features a section for information on the stock of collateralized debt as a memo item, as this type of debt can lead to specific vulnerabilities. The Fund notes the importance of identifying parts of debt where the collateral is unrelated to the loan.
- **Domestic debt.** The Fund also expects that in establishing a debt holder profile that debtors provide the composition of public debt by instruments (e.g. bonds, loans, T-bills), along with a breakdown between non-resident and resident holdings, if available. In the case of resident institutions, reporting on individual creditors is encouraged but not required.

[19] *Guidance Note On Implementing The Debt Limits Policy In Fund Supported Programs*, IMF, May 25, 2021.

VI. Refinements to the Use of Collective Action Clauses

- *Leland Goss*[20]

Collective action clauses ("CACs") are used in bond contracts to allow changes to the terms of bonds by a vote of their bondholders. Bonds historically required unanimous consent of all bondholders to change any important terms such as, for example, reducing the payment of principal and/or interest to bondholders. This created an incentive and the ability for some bondholders to vote against such proposals and effectively block sovereign borrowers from restructuring their debt by holding out for payment in full, in accordance with the original terms of the bonds.

The introduction of CACs in sovereign bonds typically allows a supermajority, for example, 75% of all bondholders to vote in favor of a debt restructuring proposal that is legally binding on all holders of the bonds, including those who vote against the proposal. In this way CACs have helped overcome problems in the past with creditor coordination and holdouts and have thus made sovereign debt restructuring more orderly and predictable.

CACs have become increasingly prevalent in sovereign bonds since at least the early 2000s (see Chapter II). In a major enhancement of the sovereign debt restructuring process, the G20 and IMF in 2014 endorsed revised collective action clauses developed and published by the International Capital Market Association (ICMA). These included an "aggregated, single limb" clause that allows bonds to be restructured on a single vote across all series or a sub-aggregation of series of bonds. The ICMA standard form terms include a single-limb voting procedure, a two-limb aggregated voting procedure and a series-by-series voting procedure, as well as a new standard form *pari passu* clause. The purpose of single-limb, aggregated voting is to minimize or eliminate the ability of holdout creditors to obtain a blocking position in any one series and thereby defeat a restructuring that otherwise has support from creditors.

Despite some initial uncertainty whether acceptance of the new clauses would require a premium to be paid to new money investors, the uptake of ICMA enhanced collective action clauses has been strong. Since the IMF's and G20's endorsement of enhanced CACs in 2014, almost all new international sovereign bond issuances by emerging markets debtors have included such clauses (Chart 5). Moreover, while earlier research studies found no adverse pricing impact from the addition of single-limb CACs, a more recent study that examines the now substantial pool of bonds with enhanced CACs in the post-2014 period has found bonds with CACs to trade at significantly lower yields in secondary markets, particularly for non-investment grade bonds that have a greater probability of sovereign default.[21]

ICMA CACs have received widespread acceptance by the market. However, as the IMF has noted, enhanced CACs have only just begun to be used in sovereign debt restructurings and there is still a large outstanding stock of international sovereign bonds without these clauses. As CACs cannot be introduced retroactively into legacy sovereign bonds, it will be some years before pre-existing debt matures and is replaced with a critical mass of sovereign debt stock with the enhanced CACs. A further limitation of the contractual, market-based framework used is that adherence to any new standard reached by debtor and creditor consensus is wholly voluntary, and there is little to stop debtors and/or creditors from changing and departing from that standard if they are minded to.

[20] Managing Director and General Counsel, Member of the Executive Committee, *International Capital Markets Association*

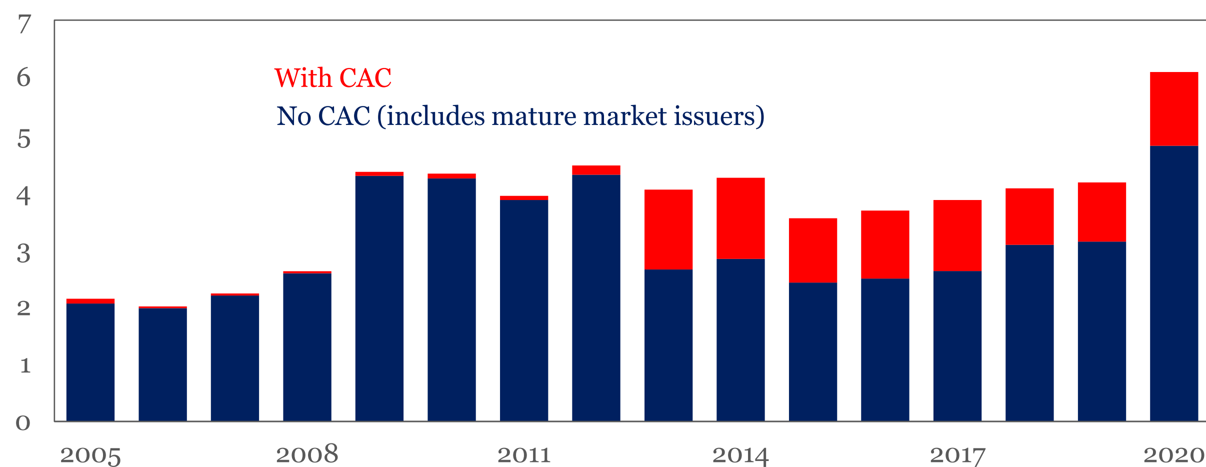
[21] Kay Chung & Mr. Michael G. Papaioannou, 2020. "**Do Enhanced Collective Action Clauses Affect Sovereign Borrowing Costs?**," IMF Working Papers 2020/162, International Monetary Fund.

Enhanced CACs were used for the first time in the 2020 Ecuador and Argentina bond exchanges; however, the single-limb voting feature in the enhanced CACs, considered to be the more effective option for issuers when these were adopted in 2015 was not used. Instead, in both cases the debtor used the two-limbed voting alternative included in the enhanced CACs. Significantly, both debtors employed novel and controversial legal techniques that caused concern among legal experts and strong objection from creditors. As a compromise, additional clauses proposed by creditors were agreed that would mitigate the use of these legal techniques in future restructurings of the affected bonds.

The Ecuador and Argentina restructurings provided the opportunity to use enhanced CACs for the first time and although these entailed certain unforeseen legal modifications and did not use single-limb aggregated voting, both restructurings were closed with high participation rates. Since that time the IMF, ICMA and others have been monitoring market developments to assess whether additional revisions to the enhanced CACs might be warranted. However, in almost all subsequent restructurings the market has adhered to the ICMA standard and not adopted the variations seen in the Argentina and Ecuador restructurings, generally pointing toward leaving the prevailing market standard unchanged at this time.

Chart 5: Collective action clauses in sovereign bonds have become more prevalent

$ trillion, sovereign bond issuance in international markets



Source: Bloomberg, IIF

Box 5. UK G7 Private Sector Debt Working Group

Under a G7 mandate, the UK has convened a Private Sector Debt Working Group to consult with private sector creditors in the pursuit of 1) sovereign loan restructuring as a majority lender consent matter and 2) expanding climate-resilient debt instruments to a broader set of events beyond climate change such as natural disasters and pandemics, and a broader set of geographies beyond the Caribbean. Since mid-2021, two dedicated expert subgroups have been launched to facilitate technical discussions on these topics. At the request of the UK Treasury, the IIF has been supporting the work of both subgroups and continues to facilitate dialogue between the private sector and the G7 on these topics. An IMF team has also been engaging with this initiative and participating in discussions together with the relevant industry bodies and G7 representatives.

Private sector views: Private creditors have constructively engaged in these working groups, participated in discussions with the IIF and provided feedback to the UK Treasury. Feedback received from IIF members, including those taking part in the UK G7 Private Sector Working Group as well as broader groups such as the PCG and the IIF Committee on Sovereign Risk Management (CSRM), suggests that:

1. **Majority voting provisions—need to better define the problem:** Private sector participants in the UK-G7 Private Sector Debt Working Group have taken on board the request to consider whether evaluation and updating of customary terms in sovereign loan agreements—on a voluntary and forward-looking basis—could potentially have benefits for all concerned parties and broader shareholders. Private creditors, however, have requested a clearer articulation of the goals of such an initiative, given that loan and bond markets are markedly different, and that more detailed analysis and discussion of the substantive issues will support better and more focused development of any potential changes. On behalf of its members, the IIF has requested that further efforts be undertaken to more clearly define and to assess the goals of any proposed voluntary templated changes, including through examples of historical cases (subject to confidentiality constraints).

2. **Growing interest in climate-resilient debt instruments, but still a niche product:** Private investors have expressed interest in efforts to expand the use of climate-resilient and other state-contingent debt instruments to a broader set of event risks (see Chapter VIII) through the development of further templated term sheets, while acknowledging that defining thresholds—including for multiple trigger events—could be technically challenging. Some private creditors suggested that the use of broader GDP-linked bonds could be more practical, while others have noted that triggers such as pandemic or climate events would be evident more quickly, thus expediting needed funding.

VII. Transparency and The Timely Flow of Information

- *Kevin Daly*[22] *and Lars Bane*[23]

A. General disclosure practice

Sovereign debt issuers should ensure that they release on a timely basis comprehensive data and other information related to their fiscal developments, debt positions, and current and future policy plans. This data should be consistent with established accepted standards and norms (i.e. budget data should be released also on an accrual basis, not only cash basis) and verified by authorized domestic and international organizations, especially with regard to their accuracy, comprehensiveness, and comparability over time. Issuers should ensure through disclosure of relevant information that creditors are in a position to make informed assessments of their economic and financial situation, including overall levels of indebtedness. Disclosure of relevant information would include all sovereign and sovereign-contingent liabilities, debt management strategies and fiscal accounts. Such disclosure is important in order to establish a common understanding of the country's balance of payments and debt sustainability outlooks, and to allow creditors to make informed and prudent risk management and investment decisions. In addition to the disclosure practices of information on international bonds, issuers should provide transparency on all loans with private and bilateral lenders, official lenders, and export credit agencies. Enhanced transparency should result in improved borrowing and lending practices and will usher in more accountability of the use of proceeds, an increasingly important factor for lenders given the focus on ESG issues. Civil society will also benefit from enhanced transparency of borrowing and lending practices, which in turn will make all stakeholders more accountable for their actions. In an economic crisis, all parties will be better placed to find an orderly, timely and constructive way forward.

B. Specific disclosure practice

In line with best practices on international bonds, certain terms of all loan agreements with private and public sector lenders, and loan covenants ought to be disclosed so that all creditors can gain a thorough and timely understanding of the overall indebtedness of the country. Confidentiality clauses in loan agreements should include carve-outs to enable the required disclosure without either the lenders or the borrower being in breach of confidentiality; this will be vital in order to improve debt transparency. In the context of a restructuring, the debtor should disclose to all affected creditors maturity and interest rate structures of all external financial sovereign obligations, including the proposed treatment of such obligations; they should disclose all sovereign guaranteed obligations; any assets that have been pledged by public sector entities against these obligations; and the central aspects, including assumptions, of its economic policies and programs. The debtor should inform creditors regarding agreements reached with other creditors such as the IMF, Paris Club and non-Paris Club lenders, as applicable. Creditor engagement and transparency are important factors in order to ensure a timely and successful restructuring, which along with credible economic and fiscal policies will allow the debtor to regain access to private sector lending. Confidentiality of material non-public information must be ensured by all stakeholders.

C. Debt transparency initiatives

Various institutions have been working and collaborating on debt transparency initiatives to better assess

[22] Investment Director, Emerging Market Debt, *Aberdeen Asset Management*

[23] Managing Member, Farallon Capital Management, L.L.C.

and address debt sustainability, in particular for the world's most vulnerable countries. The OECD, with the funding of the UK government and IIF members, is supporting the implementation of the IIF Voluntary Principles for Debt Transparency through the development of a digital platform that will serve to both receive and disseminate data on sovereign debt of emerging market and low-income countries, providing timeline and aggregated data on lending, pricing and other terms to help better assess levels of sovereign indebtedness. It will be a process for lending entities to report in a transparent and user-friendly manner in accordance with the IIF Voluntary Principles for Debt Transparency, which is also key tenet of the IIF *Principles*. On a voluntary basis, the project seeks to bring together data from private institutions that lend to low-income countries and data users.

Ultimately it is in the best interest of the borrower to ensure greater transparency from a market access and market pricing perspective. The IMF has emphasized the importance of enhanced debt transparency in its paper on *The International Architecture for Resolving Sovereign Debt Involving Private-Sector Creditors* published in October 2020. In the paper the IMF not only highlighted it was working jointly with the World Bank as part of a multi-pronged agenda on debt, but also stated that the main responsibility for transparency lies with the sovereign and its creditors. The PCG welcomes the active participation of sovereigns and all creditor groups, with the goal to provide granular details on all sovereign and sovereign-contingent external liabilities. The IIF Working Group on the IIF Voluntary Principles for Debt Transparency has held various discussions with the IMF on debt transparency and recommends that the IMF provide more details on sovereign and sovereign-contingent liabilities in its Article IV surveillance and DSA reports.

Box 6. Update on IIF *Voluntary Debt Transparency Principles*

The IIF Debt Transparency Working Group (DTWG) is actively partnering with the OECD to operationalize the IIF *Voluntary Principles for Debt Transparency* (*VPDT*), which are designed to promote transparency in private sector lending to vulnerable Poverty Reduction and Growth Trust (PRGT) countries. The purpose of these voluntary Principles is to promote consistent and timely disclosure by private creditors in connection with financial transactions.

The UK government has provided donor funds to conduct a pilot project that involves the development of a repository for data provided by IIF members. Several IIF member firms have also made generous contributions towards operationalizing the data repository. These contributions will be supplemented by a modest reporting fee that will be applicable to the individual private sector reporting submissions envisaged under the *VPDT*. The public launch of the debt data portal for all users is slated for late 2021.

A comprehensive and rapid implementation of the *VPDT* requires the full support of debtor countries and the International Financial Institutions (IFIs), including the IMF and World Bank. The extensive use of confidentiality clauses in loan agreements and other debt contracts remains a major hurdle to effective data dissemination for the repository.

To facilitate effective data collection, the DTWG will draft an implementation note and template language to introduce carve-outs from confidentiality clauses to enable the submission of information to the repository. The group will also create a template letter that banks will be able to send to sovereign clients to inform them about the participation to the initiative and to highlight confidentiality carve-outs.

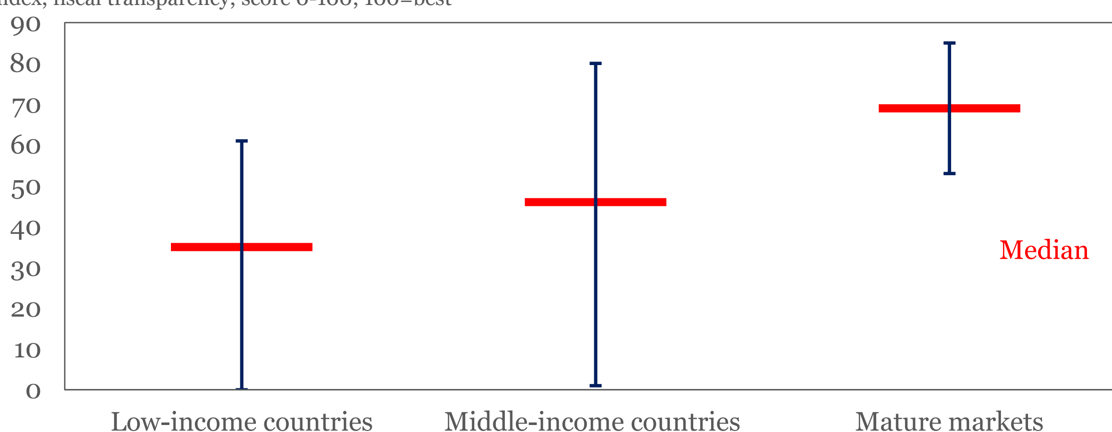
The DTWG is currently considering broadening the scope of the *VPDT* to primary issuance of government bonds and explore alternative ways to integrate this new debt transparency database with official sector data hubs to increase the value and impact of these datasets.

Box 7. Official Sector Efforts to Enhance Debt Transparency

Role of the public sector in promoting debt transparency: The international financial institutions (IFIs) and international organizations (IOs) have a crucial role to play in promoting debt and fiscal transparency. The IMF and the World Bank in particular have explicit mandates to collect and disseminate public debt data. This process includes active collaboration with other stakeholders to support capacity building in debt transparency through technical assistance (TA) and training, particularly in low-income and lower-middle-income countries (LLMICs). Despite some improvements in recent years, debt statistics remain largely incomplete for most LLMICs; in many cases, the pace of improvement does not match the needs of rapidly growing global debt markets (Chart 6). Opacity in public debt data management has long been a concern for investors, as referenced in the G20-endorsed *Principles for Stable Capital Flows and Fair Debt Restructuring*. As the pandemic wears on and more LLMICs seek international capital, these concerns continue to feature in discussions of market access. This short piece summarizes key IFI efforts to strengthen public debt transparency.

Chart 6: Lack of fiscal transparency is a significant problem for many EM and low-income countries

index, fiscal transparency, score 0-100; 100=best



Source: IIF, OBI

In search of harmonization in data reporting and dissemination: As highlighted by the IMF's Geoffrey Okamoto, lack of transparency increases uncertainty, risk, and borrowing costs. In contrast, greater transparency heightens the appeal of LLMIC debt for foreign investors. Accordingly, strengthening debt and fiscal transparency is a key responsibility for the public sector to help ensure that LLMICs have stable and affordable access to international debt markets. The IMF and the World Bank provide TA through a range of channels to address common transparency problems. These efforts involve advice on the legal and regulatory frameworks to broaden sector and instrument coverage, including on the definition of public debt. The IMF and the World Bank offer regular training covering the fundamentals of compiling and disseminating debt statistics. While there is no shortage of public sector initiatives, databases or repositories, these initiatives could benefit from greater coordination (and indeed transparency).

At present, LLMICs report debt data to four main databases, managed by the IMF and the World Bank:

International (External) Debt Statistics (IDS), Government Finance Statistics (GFS), Quarterly External Debt Statistics (QEDS) and Quarterly Public Sector Debt Statistics (QPSDS). These official databases vary in their scope, although they track similar statistics. Comparing data across these sources is a significant challenge, as definitions and coverage differ. While these differences reflect the various purposes of the databases, the data offered is far from complete in coverage of debtors, creditors, and debt characteristics, and is often at low/yearly frequency when present at all. Data reporting to the IDS is mandatory on a loan-by-loan basis. This makes it the most comprehensive data source on external debt. Yet, it is released at an aggregate level and a significant portion of the database is not publicly available. Data reported to the other databases by developing countries remain quite limited, as it is on a voluntary basis. Case in point, out of 82 LLMICs, only 15 countries report to the QPSDS, and there are substantial differences across countries in national debt definitions and coverage.

While these reporting limitations stem from a diverse set of factors across countries (and thus would be helped by more targeted case-by-case TA), the lack of meaningful incentives for sovereign borrowers to report debt data remains a major hurdle. While simpler guidance on debt recording could help boost borrower capacity, more harmonization in data reporting across these different databases could strengthen data sharing and in turn would reduce the costs of data reporting for local authorities. Targeted TA could support data monitoring and reporting about the terms and conditions of contingent fiscal liabilities—though this would require ensuring sufficient TA funding to develop Medium-Term Debt Management Strategies (MTDS).

The IMF and the World Bank's advisory services and analytics require the collection of a significant amount of qualitative and quantitative information to bridge the large information gaps stemming from the absence of consolidated public debt data. However, public access to this additional information is very limited. Although the recent enhancements in IMF/WB's Debt Sustainability Analysis (DSA) and IMF's Debt Limits Policy (See Box 4) aim to enrich the content of published DSA information (debt holder profile, composition of debt service by instrument and creditor), many DSA inputs appear to remain publicly unavailable due to confidentiality clauses or non-disclosure agreements used by official lenders. Efforts such as the OECD Debt Transparency Initiative (to operationalize the private-sector led Voluntary Principles for Debt Transparency) would gain significant momentum from improvements in public sector debt transparency—e.g., if official sovereign creditors were to refrain from using confidentiality clauses in loan agreements with LLMICs (see our recent IIF Sovereign Debt Webinar: Chinese Lending Practices and Debt Sustainability in Low-Income Countries). Private sector debt transparency initiatives would also benefit from reciprocity including greater access to information from DSAs and Medium-Term Debt Strategy. Collected directly from national authorities, the OECD Export Credit Statistics provide unique information that track cross-border export credit transactions. Yet a significant portion of the information is not publicly accessible. Allowing other stakeholders to access the full dataset through the OECD Debt Transparency Initiative would support global efforts to enhance debt transparency. Similarly, a single centralized public data repository for sovereign bond prospectuses would benefit joint efforts to enhance transparency.

VIII. New Instruments for Sustainable Financing

- *Christian Kopf*[24]

The *Principles*[25] aim to improve the stability of cross-border capital flows with the ultimate goal of increasing the level of private sector international financial intermediation. This serves a number of purposes:

- It enables the private sector to better diversify their financial investments and their sources of funding across jurisdictions,
- It allows countries and sectors to channel excess funds to where they are needed,
- It enables the financing of investments needed to meet the major challenges of our time, namely the achievement of the 17 United Nations Sustainable Development Goals, in particular measures to combat climate change and mitigate its effects.

Latin America's lost decade of the 1980s, when private capital flows were disrupted due to sovereign bankruptcies and protracted debt renegotiations, and Africa's weak economic performance while most of the continent continues to rely primarily on official development assistance and concessional financing, demonstrate that stable private international financial intermediation cannot easily be replaced by the public sector. Moreover, the fact that private investors usually pursue a profit motive helps to channel scarce resources to their most productive use. The private sector thus plays an important role in cross-border financing, as the G-20 finance ministers and central bank governors recognise in their July 2021 communiqué.[26] In the same vein, IMF Managing Director Georgieva stresses the need to "encourage more private investment in social and physical infrastructure" in Africa.[27]

In the 17 years since the *Principles* were adopted by IIF member firms and endorsed by the G-20 in November 2004, trend real interest rates in advanced economies have declined to record-low, even deeply negative levels, while capital remains scarce and real interest rates elevated in most emerging economies. Therefore, the need to improve the stability and increase the scope of cross-border financial flows in order to channel capital to where it is most needed is as relevant as ever.

Two paths can lead to more stable international capital flows:

a) Procedures that allow for fair debt restructuring and prevent arbitrary expropriation of investors,
b) Changes in contract design that reduce the likelihood of sovereign defaults and the waste of borrowing proceeds.

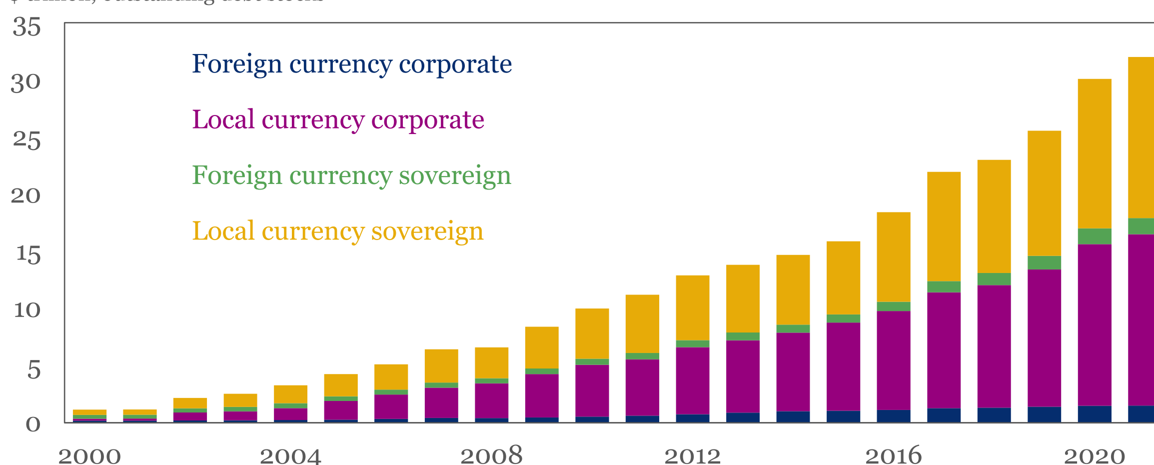
Progress has been made in both directions over the past two decades. The adoption of ICMA's single-limb aggregated collective action clauses has significantly reduced the problem of "holdout" creditors in sovereign debt restructurings (see Chapter VI). Private investors have agreed to this contractual innovation, which significantly reduces their bargaining power in debt restructuring negotiations, although it has not yet been accompanied by commitments either by issuers or by the IMF, through its lending policies, on formal engagement with creditor committees and payment of their professional advisor fees, as many had

[24] Head of Fixed Income and Currencies, *Union Investment*
[25] Principles For Stable Capital Flows And Fair Debt Restructuring, available at https://www.iif.com/Publications/ID/3490/Principles-For-Stable-Capital-Flows-And-Fair-Debt-Restructuring-Brochure.
[26] Italian G20 Presidency, Communiqué of the Third Finance Ministers and Central Bank Governors meeting, 9-10 July 2021, available at https://www.g20.org/wp-content/uploads/2021/07/Communique-Third-G20-FMCBG-meeting-9-10-July-2021.pdf.
[27] Kristalina Georgieva, "The Road Ahead for Africa – Fighting the Pandemic and Dealing with Debt", speech delivered at the African Development Bank Annual Meeting, 23 June 2021, available at https://www.imf.org/en/News/Articles/2021/06/23/sp062321-the-road-ahead-for-africa-fighting-the-pandemic-and-dealing-with-debt.

hoped.

At the same time, the shift from foreign currency to local currency lending has led to a significant decline in sovereign credit events, as countries can now better align their payment obligations with their payment capacity. Since 2004, the size of the most liquid part of emerging markets foreign currency bond markets, namely large fixed-rate government bonds, has increased from US$ 0.4 trillion to US$ 1.4 trillion (Chart 7). The total stock of local currency sovereign and corporate bonds in emerging markets now exceeds US$ 29 trillion, more than ten times the size of foreign currency debt obligations issued by these entities. During the same period, there were only eleven local currency defaults in eight countries, while private investors suffered over 35 defaults on foreign currency sovereign bonds (Table 1 – see Chapter I).

Chart 7: Emerging Market Bond Marekts



Source: BIS, IIF

Despite successes in accelerating debt workouts through aggregated collective action clauses and avoiding defaults through local currency financing, further progress is needed to increase the scale of cross-border financial flows. Future contractual innovations must take into account two important developments in financial markets.

First, government bonds have by and large become the predominant form of financing for many sovereigns in emerging markets. As a result, the London Club bank advisory committees are less frequent and sovereign debtors in financial distress now have to deal with an amorphous and atomised structure of hundreds of investors, large and small, with divergent and partially conflicting interests, often of a short-term nature. It is no longer possible to sit down with a dozen bankers and agree on changes to loan documents, and sovereign debt restructuring has become increasingly complex and costly for all parties.

Due to the high cost of sovereign debt restructuring and the associated financial stability issues, careful ex ante contract design that provides for effective cash flow relief in times of economic stress, thereby reducing the risk of sovereign default, has become increasingly important. The payment terms specified in bond contracts should be designed in such a way that the issuer's payment obligations correspond as closely as possible to its payment capacity. This payment capacity consists of tax revenues and/or sales proceeds and is usually a function of nominal GDP in domestic currency. Most payment defaults can already be avoided

if the currency mismatch between a debtor's payment obligations and its revenue stream is overcome by switching from foreign currency to local currency borrowing. The introduction of **state-contingent debt** with clearly defined pay-out structures can further reduce the risk of default in middle/low-income countries.[28] For economies known to be prone to natural disasters, this could take the form of bonds that provide rules-based payment relief in the event of hurricanes, floods or earthquakes. These instruments are discussed in greater detail in a chapter on "Sovereign Debt Instruments with Catastrophe and Disaster-related Features" in this report (see Chapter VI). By design, such natural catastrophe bonds will not shield issuers from the fallout of unpredictable events—such as pandemics—or man-made shocks—such as financial crises—and they only provide discrete debt service relief on the basis of third-party assessments. Furthermore, their asymmetrical pay-out profile may limit the attractiveness of natural catastrophe bonds for investors. From a debtor's perspective, the same holds for GDP warrants or value recovery rights, which have been issued in the context of some sovereign debt restructurings in the past. Apart from these particular forms of state-contingent debt, issuing bonds with payments symmetrically linked to the evolution of nominal GDP in local currency could play an important role in reducing the need for sovereign debt restructuring and thus in improving the stability of capital flows. GDP-linked sovereign securities with symmetrical pay-out profile would provide a continuous form of debt relief, as a function of the degree of output loss, as well as upside participation to investors in the case of strong economic performance.[29] As with the many forms of GDP warrants and value recovery rights which have been issued in past decades, careful attention needs to be given to transparency and integrity of statistics in the design of these instruments.[30]

Second, an increasing share of asset owners are explicitly considering environmental, social and governance (ESG) aspects in their investment decisions. As a result of this development, emerging economies risk losing access to capital, as most of these countries tend to score poorly on ESG factors, partly due to their lower income levels.[31] Many investors face difficulties in sourcing ESG securities in emerging markets.[32] **Nature and climate-linked bonds** with payment structures linked to environmental Key Performance Indicators (KPIs) can play an important role in preventing an exodus of sustainability-oriented investors from emerging markets.[33] These instruments are discussed in greater detail in a chapter titled "The Case for Nature-Based Solutions" in this report (see Chapter X). They can provide countries with a high need to phase out fossil fuels with the necessary investments to enable their economies to transition towards climate neutrality and long-term resilience. Moreover, climate-related investments tend to have higher economic multipliers, as a recent IMF study shows.[34] Sustainability considerations are also increasingly integrated in sovereign debt restructurings, a development which is discussed in a chapter on "ESG Considerations for

[28] For an overview of the IMF's work on state-contingent sovereign debt instruments, see https://www.imf.org/en/About/Key-Issues/state-contingent-debt-instruments.
[29] For an introduction, see Robert Shiller, Jonathan D. Ostry and James Benford (ed.), Sovereign GDP-Linked Bonds: Rationale and Design, CEPR Press, 2017.
[30] For a model set of terms and conditions for GDP-linked sovereign bonds which has been prepared with support from ICMA and other trade associations, see https://www.icmagroup.org/resources/Sovereign-Debt-Information/.
[31] A recent World Bank study finds that about 90 percent of a country's sovereign ESG score is explained by the country's level of development and that a country's national income permeates all sustainability-linked measures used by the market (cf. Gratcheva, Emery and Wang, 2020, Demystifying Sovereign ESG, Washington, DC: World Bank, https://openknowledge.worldbank.org/bitstream/handle/10986/35586/Demystifying-Sovereign-ESG.pdf.
[32] RBI Sustainable Finance Survey
[33] For an introduction to nature and climate-lined bonds, see Anderson Caputo Silva and Fiona Stewart, "My word is my bond: Linking sovereign debt with national sustainability commitments", World Bank Blog, 11 February 2021. For an introduction to industry standards on Sustainability Bonds and Sustainability-Linked Bonds, see https://www.icmagroup.org/sustainable-finance/.
[34] See Nicoletta Batini et al., Building Back Better: How Big Are Green Spending Multipliers?, IMF Working Paper 21/87.

Sovereign Debt Restructuring" (see chapter IX) in this report.

The financial industry recognises the need to work towards achieving the UN Sustainable Development Goals and the climate neutrality targets set out in the Paris Agreement. Increased stability and a greater scale of cross-border financial intermediation will make an important contribution to achieving these goals. State-contingent and nature and climate-linked securities can play an important role in this regard.

IX. ESG Considerations for Sovereign Debt Restructuring

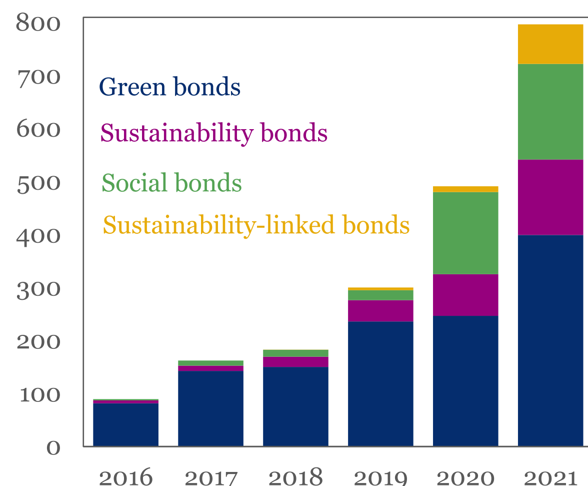
- *Matthew Graves*[35]

Environmental, social and governance (ESG) considerations have grown rapidly in importance in sovereign debt markets. The drivers of this shift in perspective are myriad. Changing expectations on the part of asset owners have broadened conceptions of fiduciary duty, while regulatory authorities and the official sector increasingly consider environmental and social sustainability as relevant considerations in debt sustainability and sovereign risk assessments.

Primary markets clearly reflect this shift in thinking. ESG-labelled bond issuance[36]—which includes green bonds, blue bonds, social bonds, sustainable bonds and sustainability-linked bonds, amongst others—has grown by more than twofold since 2019 (Chart 8). While the bulk of this issuance has been concentrated in developed markets (See Box 8), labeled bonds issued by emerging market sovereign issuers has also picked up more recently (Chart 9). It is reasonable to expect these trends to deepen as the global regulatory environment evolves, encouraging both greater consideration of ESG factors in investment decisions, and greater transparency with respect to the sustainability characteristics of specific investments.

Chart 8: Global ESG Bond Issuance

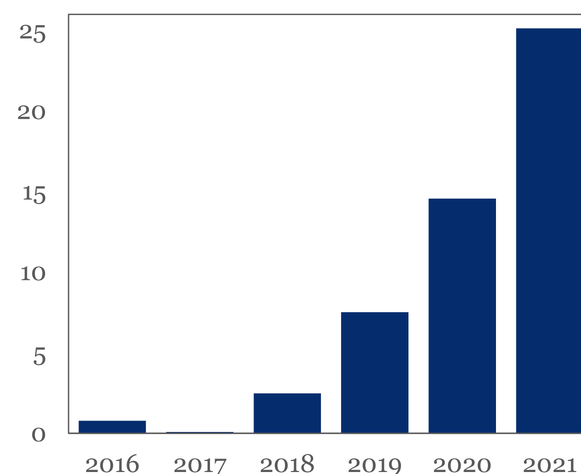
$ billion, till mid-October '21



Source: IIF, Bloomberg

Chart 9: ESG Bond Issuance by EM Sovereigns

$ billion, till mid-October '21



Source: IIF, Bloomberg

Given this context, the importance of ESG integration in sovereign debt restructurings seems clear. These processes tend to have a longer-term focus that places "sustainability" at the center of the discussion, providing a natural basis for the borrower and its creditors to engage on ESG themes. It is reasonable to expect ESG-aligned commitments by the borrower to support its credit trajectory, which in turn helps justify creditors' provision of relief. Adhering to these commitments can also provide an important medium-term signal of intent to the market, while improved transparency on sustainability factors will open the

[35] Emerging Markets Sovereign Research Analyst, *Western Asset Management*

[36] See here for guidance from the International Capital Markets Association (ICMA) for principles guiding these issuances: https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/

possibility of tapping into new pools of capital. In each case, ESG-related commitments have the potential to help issuers regain market access more quickly and at a more affordable cost.

To date, sovereign and sub-sovereign debt restructurings have generally not incorporated ESG considerations, despite concerted investor attempts to achieve this aim in certain cases. Recent one-off developments provide an encouraging signal that progress toward this goal can be achieved.[37] However, a replicable mechanism to layer ESG considerations into restructured market debt has, so far, remained out of reach. This is, at least in part, a function of country-specific challenges. However, we think it's worth considering three broader themes that have also limited progress thus far:

(1) **Imperfect commitment mechanisms.** Because restructurings are not new-money transactions, incorporating ESG components into new bonds will require the borrower to commit to certain actions in the future. While there are many ways to think about this construct, it is clear that if *relief* is to be provided in exchange for ESG commitments, then an enforcement mechanism must exist in the event the borrower does not adhere to those commitments. This implies the issuer must accept conditionality imposed by private sector financial institutions. And these commitments—particularly on the environmental side—often extend beyond the mandate of a country's economic authorities, both in terms of scope (cross-ministry impact) and time horizon (commitments extend across political cycles). This introduces a number of political perception and planning issues that complicate a sovereign's ability to commit to ESG conditions and report on progress in a robust manner.

(2) **Timing and logistical constraints.** Sovereign restructurings are complicated. Simply getting to economic terms in a timely manner often exhausts the available bandwidth on both sides of the table. And, as outlined above, resolving issues related to commitment mechanisms is a challenge in its own right. However, trying to resolve this disconnect under tight timelines, with a heterogenous creditor base that has varying attitudes toward ESG—all in the context of the structural antagonism that exists between debtor and creditor positions—has so far proven difficult to overcome.

(3) **Transparency and impact.** Incorporating ESG criteria into any market debt instrument—whether at issuance, or as a result of a restructuring—seeks to impact environmental, social or governance outcomes. However, without transparency on where and how much governments spend on each of these priorities, market participants will have a structurally incomplete picture of potential impact.[38] Without the ability to appropriately gauge impact, determining the appropriate level of relief to provide in exchange for ESG commitments becomes quite subjective, while concerns with respect to "greenwashing" or "bluewashing" also become more acute.

Environmental, social and governance factors will gain in importance over time—regulatory trends, alone, essentially assure this. Identifying mechanisms that allow sovereign debt restructurings to incorporate these factors is a realistic objective. In the context of challenges encountered to date, a process that is:

(1) narrowly focused

---

[37] Build on Seychelles' earlier debt for nature swaps, Belize's proposed "Blue Bonds" restructuring—which leverages new money from The Nature Conservancy to retire existing market debt, at a discount, in exchange for stepped-up commitments on marine conservation—presents an encouraging data point in favor of the eventual inclusion of ESG characteristics as a component in restructured market debt.

[38] As an example, if a government commits to improving outcomes on clean water and sanitation (SDG6) to comply with its (theoretical) contractual ESG commitments but does so by diverting spending from infrastructure projects to mitigate flooding risks, the net ESG impact clearly does not align with investor intentions.

(2) primarily within the remit of economic authorities
(3) inclusive of environmental and social budget disclosures

can provide an achievable path for broad and replicable progress. It would also establish a strong foundation for ESG engagement moving forward, potentially expanding an issuer's access to global capital markets, while also building the foundation for deeper and more targeted ESG KPIs in the future.

Box 8. Greening EM Bond Markets

Growing reliance on bond markets: Bond markets have become an increasingly important source of financing for emerging markets and developing countries over the past decade. Since the onset of the 2008 financial crisis, the size of EM bond markets has more than tripled, breaching the $25 trillion mark in 2020. The growing use of bond markets in project financing has also been evident in capital flows to emerging markets, with the share of bonds in total EM capital flows increasing from an average of 9% over 2001-2010 to around 20% over the past decade.

Greening EM capital flows: Although many EM sovereigns and firms are increasingly reliant on bond issuance for project finance, ESG integration in EM bond markets has been slow, with investors increasingly facing difficulties in sourcing ESG-aligned securities in emerging markets. Case in point, global ESG debt issuance was over $800 billion in the first 8 months of 2021, but only 10% of that came from emerging markets. At around $250 billion, ESG-labelled bonds represent less than 0.1% of outstanding EM bonds, and issuance activity is concentrated in just a few countries, including China and Chile—see the IIF Sustainable Debt Monitor. Scaling up emerging market ESG bond markets would help galvanize domestic and international resources towards green and sustainable investment projects. Indeed, mobilizing private capital is particularly important for achieving the sustainable development goals (SDGs). Cross-border climate finance flows into emerging markets still fall well short of those needed to close the climate-related SDG financing gap: at an estimated level of $86 billion in 2020, climate finance flows to EMs and low-income countries accounted for less than 8% of total cross-border capital flows into these countries. Official bilateral and multilateral creditors continue to be the main source of external financing for climate-related projects in EMs. Cross-border private climate finance flows are still limited, and often volatile. Against this backdrop, scaling ESG bond markets could be an effective way of steering international private capital towards climate and broader sustainable investments in emerging markets. With an increasing number of companies committing to reducing carbon emissions, there has been an upswing in international investor appetite for EM ESG-labelled debt securities in recent months.

Looking ahead, effective integration of ESG considerations in EM bond markets could also help market participants price ESG risk appropriately, which in turn should increase financial resilience in emerging markets. However, there are still a number of impediments to ESG integration in EM bond markets:

- Need for more standardization, clear taxonomy for debt securities (labelling, certification, terminology);
- Lack of transparency and information flow;
- Limited project pipeline (challenges in identifying projects and assets that meet relevant ESG criteria);
- High issuance costs (associated with independent verification and second-party opinions);
- Limited technical capacity to underwrite ESG bonds;
- Low public awareness about ESG issues in many EMs weighs on domestic demand for ESG securities.

X. The Case for Nature-Based Solutions

- *Deborah Zandstra [39] and Adeline Tsui [40]*

A. Background

With rising temperatures, climate change has become an increasingly hot topic for the world. Indeed, the depth of international consensus on tackling climate change continues to broaden, with countries aligning to Net Zero since the Paris Agreement in 2015, and the upsurge of green financing over recent years has helped raise the profile of important ESG factors across debt and equity markets, including in the sovereign debt sphere.

Less attention has been paid to the ecological importance and economic opportunities of biodiversity however, which should itself be at the forefront of government thinking and policymaking. As national leaders, sovereign borrowers could benefit from exploring how to raise finance for projects that can preserve and restore natural capital, which can in turn enhance a range of broader climate-related resilience and social objectives. The key is to align economic interests with environmental ones, by transforming natural capital into a clearly quantified asset.

B. The Problem with Debt

While the proceeds of green, social, blue and sustainable and sustainability-linked financial instruments serve to further worthwhile expenditures, they still result in a country incurring debt. Debt by its nature creates an ongoing liability and ultimately demands repayment, in one way or another. Middle and low-income countries which are under economic and political pressure to meet development goals may be more reluctant to incur more debt linked purely to ESG use of proceeds because it skews the debt to GDP ratio. This can further widen the developmental rift between countries and support the continuing pursuit of economic growth at the expense of the ecological.

The suggestion is to turn instead to natural capital (forests, mangroves, coral reefs etc.) as sources of finance, and to start thinking of existing natural resources as long-term opportunities for sustainability and economic growth.

C. Nature-Based Solutions: The Way Forward

Nature-based solutions fundamentally rely on making use of existing natural capital to mitigate climate change risks and loss of biodiversity and to develop climate resilience. Examples include the creation of reed beds at water treatment plants to absorb contamination and encouraging sheep farmers to plant more trees to prevent heavy rains eroding hillsides. In Indonesia, the government has collaborated with international organizations to plant mangroves to tackle eroding coastlines, protect coral reefs and slow storm surges.

Importantly, nature-based solutions can provide an alternative to sovereign financing that does not rely on perpetuating the debt cycle by integrating nature into debt arrangements (e.g. debt for nature, nature performance) and by accessing financing through new environmental market instruments (e.g. carbon credits). We see this in Gabon for example, in the recent arrangement that enables Gabon to receive USD 150 million over 10 years for protecting its carbon-absorbing tropical forests, and a guaranteed payment from Norway of at least USD 10 for each tonne of carbon certified as being stored. By aligning economic and ecological interests, this initiative is an example of how preserving rather than depleting natural

[39] Partner, Clifford Chance LLP
[40] Trainee Solicitor, Clifford Chance LLP

resources can also benefit countries and emerging markets financially as well as from the perspective of mitigating loss of biodiversity.

Similarly, debt-for-nature swaps such as Seychelles with the Paris Club (some official sector debt relief in exchange for marine conservation milestones) would continue to provide a dual means to alleviating financial pressure and strengthening climate resilience. Pakistan's "Nature Performance Bond", under which it hopes to receive debt rebates from the UK, Germany, Italy, and Canada in exchange for quantifiable conservation efforts is an interesting reference point for nature linked transactions.

D. From Theory to Practice

Any work in this area requires long term vision by governments beyond one administration only and the ability to work across government.

Data is critical. For example, the amount of carbon being sequestered by forests must be clearly quantified before forests and other types of natural capital can be monetized through the generation of carbon credits, or other means. The key is to be able to monetize and present the capabilities of natural system in a way that relevant stakeholders, investors and other market participants can understand and integrate into their decision making.

Governments will also need the support of ecologists, biodiversity specialists and NGOs to optimize the potential of nature-based solutions as well as the more traditional financial markets infrastructure providers and financiers. A lot of technical work has been driven to date and will need to continue to be driven both in terms of technical assistance and blended finance by multilateral development banks (MDBs), presenting an opportunity for greater collaboration between sovereigns, multilaterals, and the private sector and for the development of interdisciplinary expertise.

In conclusion, from the perspective of sovereign debt, nature-based solutions provide an economically and ecologically harmonious approach towards debt and natural wealth management. The focus now should be for the governments of countries with significant natural capital to protect and restore it and create innovative finances and structures that can support investment into this critical asset class. Governments need to adopt a long-term vision that does not underestimate the preliminary and technical work needed along the way by collaborating with MDBs and the private sector to protect future generations.

XI. Sovereign Debt Instruments with Catastrophe and Disaster-related Features

- *Deborah Zandstra* [41]

A. Background

Catastrophe and disaster-related sovereign debt instruments (referenced to as 'CRDI' bonds) incorporate provisions which extend debt servicing obligations if one or more specified events, such as a hurricane of at least a pre-specified severity, occurs. Work on new sovereign debt instruments with these features has been ongoing for some time. [42]

Further, the marketplace has seen some relevant issuances in the Caribbean. A limited natural disaster feature was included in bonds issued as part of restructuring arrangements by Grenada and then by Barbados.

The potential benefits for the issuing country are clear, and policymakers are keen to promote sovereign debt instruments with these features. In an IMF Staff Paper dated September 23, 2020, entitled 'The International Architecture for Resolving Sovereign Debt Involving Private-Sector Creditors – Recent Developments, Challenges, and Reform Options' the IMF, while recognizing some limitations, noted that 'state contingent features in sovereign debt instruments can help protect the sovereign from downside risk, especially to cover situations involving natural disasters.' This was followed by an IMF Staff Discussion Note in November 2020 entitled 'The Role of State-Contingent Debt Instruments in Sovereign Debt Restructurings' which also acknowledged the benefits associated with the issuance of sovereign debt instruments with payment features linked to natural disasters.

The manifestation of increasingly severe and frequent climate-related natural disasters over the course of 2021 has raised the specter of existential threats to vulnerable populations, and even in entire countries, in the case of small island developing states. In the year of the COP 26, there is increasing recognition that many countries face the prospect of both greater frequency and severity of natural disasters when compared with the past. Many affected countries are also economically fragile, and their financial position has been exacerbated by the COVID -19 pandemic. The pandemic itself has shown how sovereign debtors face unexpected financial and other fragilities, especially in low-income countries.

In both of these IMF Staff papers it was noted that increased use of sovereign debt instruments with payment features linked to natural disasters could be usefully considered. At the G7 level, there is now a desire to utilize debt instruments with these features for a broad set of countries and circumstances, particularly in a post global pandemic environment. Genuine voluntary issuances, in contrast to issuances in a narrow subset of sovereign debt restructuring arrangements, are to be encouraged.

B. The Process

G7 members see the merits of drawing upon the private sector to help craft new sovereign debt instruments with payment features linked to natural disasters. The successful exercise in the field of international sovereign bonds which culminated in the publication by ICMA of the August 2015 CACs, which are now the market norm for sovereign bond issuances, was initiated through an expert group formed at the request of the US Treasury in which, among others, the IMF and ICMA participated. In broad terms, that approach of

[41] Partner, Clifford Chance LLP

[42] ICMA published three Indicative Heads of Terms for hurricane related instruments in November 2018 and invited comments from interested parties.

establishing an expert group has been replicated for this exercise. The UK Treasury under the current UK Presidency of the G7 is taking the lead. With the assistance of the IIF, a G7 Private Sector Working Group has been established including a sub-group to consider specifically new sovereign debt instruments with these features and the IMF and ICMA are participating.

It may be helpful to share a brief description of the overall objective and main points under consideration.

C. The Overall Objective

The expectation is that the eventual output of the subgroup will be the publication of a model Indicative Voluntary Heads of Terms for CRDI bonds for use in the marketplace by sovereign debtors, lead managers and investors.

D. Central Feature which diverges from existing standard sovereign debt instruments

The key distinguishing feature of CRDI bonds is that they will contain a contractual deferral of specified payments (principal and interest) upon the occurrence of one or more natural disasters.

E. Related Areas under Consideration

***Typical Issuer*:** would be low-income countries and small island developing states.

***Trigger Events*:** climate disasters and wider shocks (e.g. pandemics) are in contemplation. It is understood that objectively verifiable criteria provided by a third party for the relevant event and its severity are important to provide certainty.

***Additional Conditions to Deferral*:** consideration will be given as to whether there should be additional conditions to deferral (e.g. no prior default; IMF membership etc).

***What is to be Deferred*:** the expectation is that both interest and principal falling due within a specified period (e.g. 1 year) would be deferred. The objective is to provide cash flow relief.

***Automatic or Option to Defer*:** thought is also being given to whether any deferral should be automatic or at the option of the issuer.

***Terms of the Deferral*:** DSSI is one reference point. This provides for a repayment period of 5 years (after a 1-year grace period). Capitalization of the deferred amounts is in contemplation.

Frequency: it is understood that the issue of how often a deferral may occur is important and this is being considered.

Sequencing: it is also understood that thought needs to be given to the prospect of multiple sequential potentially triggering events and their impact on deferral.

F. Issues for Investors

By incorporating a deferral feature referable to the occurrence of natural disasters, CRDI bonds take a step closer to a private sector insurance arrangement. This is new territory for a typical fixed income investor used to hedging credit risk through credit default swaps or other risk amelioration mechanisms. However, it is important to draw out one point. In a classic insurance arrangement, the insurer makes irrecoverable payments upon the occurrence of one or more insured perils (e.g. a hurricane). CRDI bonds provide cash flow relief, so the investor's cash flow is postponed rather than lost in the way it would be under a classic insurance structure.

It is understood that in addition to commercial considerations, such as any coupon uplift to reflect the risk

of cash flow relief, regulatory, accounting, tax and credit ratings factors will need to be examined as part of the work of the CRDI bond expert group.

G. Private Sector Opportunity and Timing

The CRDI bond initiative is as an opportunity for the private sector to assist in shaping the output of the CRDI bond group in a market friendly manner. It is clear that there is considerable resolve within the G7 to promote the voluntary uptake of CRDI bonds in a way which increases liquidity (and thereby hopefully drives down price), particularly as the pandemic begins to abate in many of the countries likely to contemplate their issuance. It is understood that CRDI bonds give rise to new considerations for many of the typical fixed income investors in sovereign bonds.

It is difficult to predict when the work of the CRDI expert group will be complete but there is considerable impetus being provided by G7 member countries. It is expected that the work will also be replicated into a loan term sheet.

XII. Ratings Considerations in Sovereign Debt Markets

- *Elena Duggar* [43]

Sovereign ratings have proven effective in rank-ordering default risk, with less volatility than market signals

A. Growth in sovereign ratings reflects market deepening

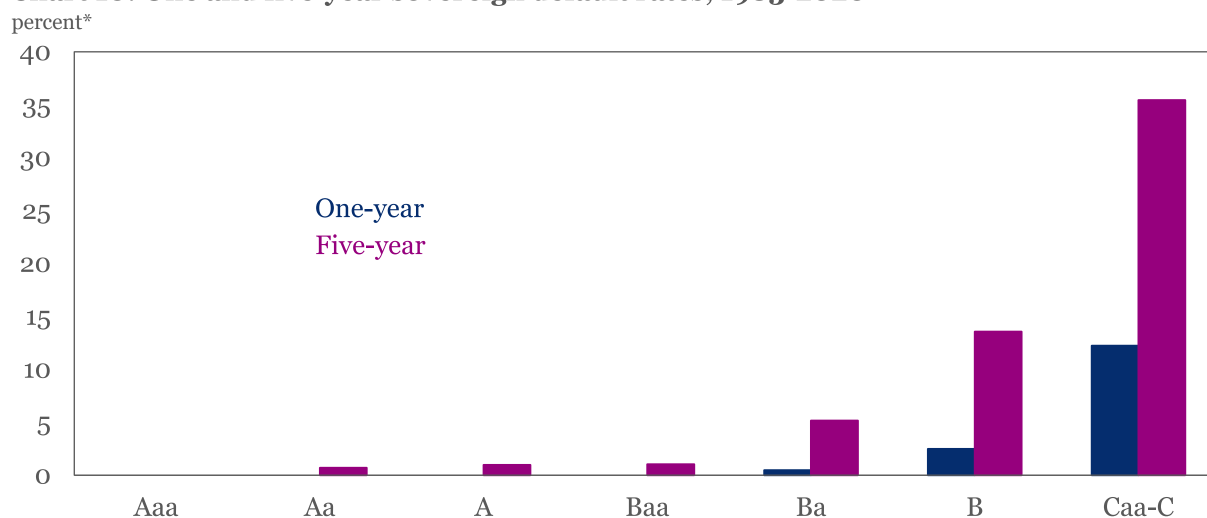
National governments are the largest capital market borrowers. Their credit profiles serve as benchmarks in the world's capital markets. For investors, a predictive and timely appreciation of sovereign default risk is critical. As a complement to investors' own analysis, credit ratings can provide an independent assessment and a relative rank ordering of sovereign credit risk. Rating independence promotes market transparency by allowing credit rating agencies (CRAs) to objectively opine regardless of the impact on rated credits or the market. Relative-risk analysis contributes to a more efficient flow of capital worldwide.

The number of Moody's rated sovereign issuers grew to 144 in 2020, from 113 in 2010 and 100 in 2000, reflecting the deepening of global financial markets and increasing access to finance for emerging market sovereign issuers.

B. Ratings have effectively rank-ordered default risk

Sovereign ratings place issuers in different risk categories. Benchmarked against actual default experience, these risk categories have proven effective in rank-ordering default risk. A close look at Moody's default data over the last four decades demonstrate that higher-rated countries default less frequently than lower-rated countries over both short- and long-term horizons. No sovereign government has defaulted within five or even 10 years of being rated Aaa, or within a year of being rated investment grade. In the speculative-grade rating categories, default rates rise sharply as sovereigns move down the rating scale (Chart 10). Additionally, since 1983, sovereigns that have defaulted have had a lower rating than 94% of rated sovereigns one year prior to default.

Chart 10: One and five-year sovereign default rates, 1983-2020



Source: Moody's Investors Service; *issuer-weighted cumulative default rates, averaged over monthly

[43] Chair of Moody's Macroeconomic Board, Associate Managing Director, Moody's Investors Service

C. Ratings have been more stable than market measures

Further, ratings have been much less volatile than other market measures of sovereign credit risk and have served as a moderating force through periods of tightening market liquidity, including through the COVID-19 pandemic. When changes do occur, ratings are much less likely to be reversed within a short period of time. For example, only 0.4% of Moody's ratings reverse within a year, whereas more than 80% of all moves in bond yield-implied ratings are reversed within a similar timeframe (Table 3). Large rating migrations, even in the highly stressed environment of 2020, have been limited.

Table 3: Average annual volatility statistics (as percentage of issuers, 1999-2021H1)

Sovereign issuers	Moody's Ratings	Bond yield-implied ratings*
Share experiencing one or more rating changes	19%	81%
Share experiencing large rating changes (more than 2 notches)	2%	25%
Share experiencing a rating change reversal within 12 months	0.4%	81%
Average number of rating changes over 12 months for issuers that experience a rating change	1.5	3.2

*Source: Moody's Investor Service; *Bond yield-implied ratings are observed at monthly intervals, their volatility statistics would be higher if measured at more frequent intervals.*

D. Rating approach through the pandemic has been measured and focused on most exposed issuers

The health crisis, deep economic contraction, uneven access to liquidity and lower commodity prices created a severe credit shock across many sectors and regions in 2020. In such an environment of broad deterioration in credit quality. Moody's rating actions across asset classes have been selective and concentrated on the most vulnerable sectors and issuers.

Further, the pandemic has led to a sharp increase in debt levels among sovereign issuers. But one-off increases in debt burdens do not typically trigger sovereign rating changes. Credit analysis focuses on lasting changes to sovereign credit profiles arising from a shock. Thus, in most countries, the rating implications of the pandemic will depend on the economic recovery and on the ability of countries to stabilize their debt trajectories over time and ahead of future shocks.

Debt relief under the DSSI helped alleviate liquidity pressures in 2020 and 2021 and has allowed governments to devote fiscal resources to essential health efforts and social spending to combat the pandemic. However, in most cases, DSSI debt relief was modest relative to coronavirus-related fiscal pressures. Thus, overall, most emerging and frontier-market economies experienced a negative credit shock and saw a sharp deterioration in fiscal space.

The sovereign bond rating process considers many economic, institutional, financial and political parameters, that may affect a government's creditworthiness. Environmental, social and governance (ESG) risks are integrated into Moody's credit analysis and incorporated in various ways. For example, environmental risks relate to the economic and fiscal impact of shocks specific to each sovereign's environment. Social considerations encompass risks to sovereign's credit profiles that derive from society's characteristics and structure. Governance issues are integral to the assessment of institutional and governance strength. Consistent with the ratings' sole focus on creditworthiness, in the event of debt

restructurings, ratings will reflect an expectation of default if investors are likely to suffer losses, but upon the conclusion of the debt restructuring, subsequent ratings will reflect the benefits of debt relief.

E. Ratings have emphasized differentiation during periods of liquidity stress

CRAs operate under a code of conduct consistent with internationally accepted regulatory principles derived by IOSCO, which require that CRAs avoid both forbearance and taking a credit rating action based on its potential effect on the rated entity or the broader economy. This requirement exists in part to promote market transparency and as a mechanism for CRAs to manage conflicts of interest. Forbearance would require CRAs to take actions that are not based on the creditworthiness of an entity, violating those principles the market uses to hold CRAs accountable. Moreover, forbearance would be harming markets by removing a measure of credit risk that serves as a moderating force during periods of liquidity stress.

Through the COVID-19 crisis, ratings activity has continued to emphasize the large differentiation in creditworthiness among countries. The human toll and path of the pandemic, along with the economic recovery, is uneven across countries and regions; it is also uneven within countries. Countries also entered 2020 in very different positions. Access to liquidity, ability to provide policy support, debt structures and debt servicing costs differ greatly. Ratings continue to reflect this differentiation, including during periods of market tightening.

ANNEX I. The Principles For Stable Capital Flows And Fair Debt Restructuring[44]

Preface

Since the mid-1990s, sovereign debtors and their private sector creditors have generally sought to put in place policies and procedures likely to promote and maintain sustained market access.

Most issuers have recognized the importance of implementing sound economic and financial policies (including monetary, exchange rate and debt management policies), as well as developing domestic public support for those policies. Equally important are policies that preserve the rule of law and, in particular, maintain the sanctity of contracts, as well as other measures needed to advance an open investment environment. In maintaining sound policies, debtors have been guided by internationally accepted standards and codes to strengthen financial stability and to enhance transparency by providing timely economic and financial data.

For their part, most creditors make investment and lending decisions on their own merit, accept full responsibility for these decisions, and do not expect official sector bailouts. As part of this process, creditors have sought to implement good practices in risk management, including thorough analysis of a borrowing country's implementation of sound economic and financial policies, as well as adherence to key standards and codes.

More recently in a significant step toward strengthening the resilience of the system, most debtors and their creditors have opted for the voluntary inclusion of collective action clauses (CACs) in international bond terms and conditions. These bonds have provided for amending payment terms through supermajority voting and for limiting precipitous legal actions through higher acceleration hurdles; a few bonds have also included provisions for debtor-creditor engagement.

In a growing number of cases, both issuers and creditors have pursued effective, two-way communication through robust investor relations programs (IRPs). This communication includes information and data on the issuer's key economic and financial policies and performance, with creditors providing feedback.

These Principles outline actions and behaviour of private sector creditors and emerging market sovereign debtors to promote and maintain stable private capital flows to emerging market economies in the context of growth and financial stability. They are based on extensive and broadly based discussions among private creditors and sovereign emerging market issuers. Because individual cases will invariably involve different circumstances, the Principles should be applied flexibly on a case-by-case basis, and are strictly voluntary. Accordingly, no party is legally bound by any of the provisions of these Principles, whether as a matter of contract, comity, or otherwise. Moreover, nothing in these Principles (or in any party's endorsement thereof) shall be deemed to constitute a waiver of any such party's legal rights.

The Principles build on the progress since the mid-1990s to identify effective measures in order to shore up crisis prevention and encourage their continued implementation. The Principles promote early crisis containment through information disclosure, debtor-creditor consultations, and course correction before problems become unmanageable. They also support creditor actions that can help to minimize market contagion. In cases where the debtor can no longer fulfil its payment obligations, the Principles outline a

[44] During the annual meeting of the Group of Trustees on October 10, 2010, the Trustees agreed to broaden the applicability of the Principles to go beyond the traditional emerging market sovereign issuers to encompass on a voluntary basis all sovereign issuers, as well as cases of debt restructuring in which the state plays a major role in influencing the legal and other key parameters of debt restructuring, based on the recommendation of a PCG Working Group on the Applicability of the Principles. The Group of Trustees also agreed to drop the reference to emerging markets from the title of the Principles. For more details, see Annex II of the October 2010 Report of the PCG on the 2010 Implementation of the *Principles for Stable Capital Flows and Fair Debt Restructuring*.

process for market-based restructuring based on negotiations between the borrowing country and its creditors that involve shared information, are conducted in good faith, and seek to achieve a fair outcome for all parties. Such a process maximizes the likelihood that market access will be restored as soon as possible under sustainable macroeconomic conditions.

Principles

1. Transparency and Timely Flow of Information

General disclosure practice. Issuers should ensure through disclosure of relevant information that creditors are in a position to make informed assessments of their economic and financial situation, including overall levels of indebtedness. Such disclosure is important in order to establish a common understanding of the country's balance of payments outlook and to allow creditors to make informed and prudent risk management and investment decisions.

Specific disclosure practice. In the context of a restructuring, the debtor should disclose to all affected creditors maturity and interest rate structures of all external financial sovereign obligations, including the proposed treatment of such obligations; and the central aspects, including assumptions, of its economic policies and programs. The debtor should inform creditors regarding agreements reached with other creditors, the IMF, and the Paris Club, as appropriate. Confidentiality of material non-public information must be ensured.

2. Close Debtor-Creditor Dialogue and Cooperation to Avoid Restructuring

Regular dialogue. Debtors and creditors should engage in a regular dialogue regarding information and data on key economic and financial policies and performance. IRPs have emerged as a proven vehicle, and countries should implement such programs.

Best practices for investor relations. Communication techniques should include creating an investor relations office with a qualified core staff; disseminating accurate and timely data/information through e-mail or investor relations websites; establishing formal channels of communication between policymakers and investors through bilateral meetings, investor teleconferences, and videoconferences; and maintaining a comprehensive list of contact information for relevant market participants. Investors are encouraged to participate in IRPs and provide feedback on such information and data. Debtors and investors should collaborate to refine these techniques over time.

Policy action and feedback. Borrowing countries should implement economic and financial policies, including structural measures, so as to ensure macroeconomic stability, promote sustainable economic growth, and thereby bolster market confidence. It is vital that political support for these measures be developed. Countries should closely monitor the effectiveness of policies, strengthen them as necessary, and seek investor feedback as warranted.

Consultations. Building on IRPs, debtors should consult with creditors to explore alternative market-based approaches to address debt-service problems before default occurs. The goal of such consultations is to avoid misunderstanding about policy directions, build market confidence on the strength of policy measures, and support continuous market access. Consultations will not focus on specific financial transactions, and their precise format will depend on existing circumstances.

In any event, participants must not take advantage of such consultations to gain a commercial benefit for trading purposes. Applicable legal restrictions regarding material non-public information must be observed.

Creditors' support of debtor reform efforts. As efforts to consult with investors and to upgrade policies take hold, the creditor community should consider, to the extent consistent with their business objectives and legal obligations, appropriate requests for the voluntary, temporary maintenance of trade and inter-bank advances, and/or the rollover of short-term maturities on public and private sector obligations, if necessary to support a borrowing country's efforts to avoid a broad debt restructuring. The prospects of a favorable response to such requests will be enhanced by the commitment to a strong adjustment program, but will also depend in part on continued interest payments on inter-bank advances and continued service of other debt.

3. Good-Faith Actions

Voluntary, good-faith process. When a restructuring becomes inevitable, debtors and creditors should engage in a restructuring process that is voluntary and based on good faith. Such a process is based on sound policies that seek to establish conditions for renewed market access on a timely basis, viable macroeconomic growth, and balance of payments sustainability in the medium term. Debtors and creditors agree that timely good faith negotiations are the preferred course of action toward these goals, potentially limiting litigation risk. They should cooperate in order to identify the best means for, placing the country on a sustainable balance of payments path, while also preserving and protecting asset values during the restructuring process. In this context, debtors and creditors strongly encourage the IMF to implement fully its policies for lending into arrears to private creditors where IMF programs are in place, including the criteria for good-faith negotiations.

Sanctity of contracts. Subject to their voluntary amendment, contractual rights must remain fully enforceable to ensure the integrity of the negotiating and restructuring process. In cases where program negotiations with the IMF are underway or a program is in place, debtors and creditors rely upon the IMF in its traditional role as guardian of the system to support the debtor's reasonable efforts to avoid default.
Vehicles for restructurings. The appropriate format and role of negotiation vehicles such as a creditor committee or another representative creditor group (hereafter referred to as a "creditor committee") should be determined flexibly and on a case-by-case basis. Structured, early negotiations with a creditor committee should take place when a default has occurred in order to ensure that the terms for amending existing debt contracts and/or a voluntary debt exchange are consistent with market realities and the restoration of growth and market access and take into account existing CAC provisions. If a creditor committee is formed, both creditors and the debtor should cooperate in its establishment.

Creditor committee policies and practices. If a creditor committee is formed, it should adopt rules and practices, including appropriate mechanisms to protect material non-public information; coordinate across affected instruments and with other affected creditor classes with a view to form a single committee; be a forum for the debtor to present its economic program and financing proposals; collect and analyze economic data; gather, evaluate, and disseminate creditor input on financing proposals; and generally act as a communication link between the debtor and the creditor community. Past experience also demonstrates that, when a creditor committee has been formed, debtors have borne the reasonable costs of a single creditor committee. Creditors and debtors agree jointly what constitute reasonable costs based on generally accepted practices.

Debtor and creditor actions during restructuring. Debtors should resume, to the extent feasible, partial debt service as a sign of good faith and resume full payment of principal and interest as conditions allow. Debtors and creditors recognize in that context that typically during a restructuring, trade lines are fully serviced and maintained. Debtors should avoid additional exchange controls on outflows, except for temporary periods in exceptional circumstances. Regardless of the specific restructuring mechanics and procedures used (i.e. amendment of existing instruments or exchange for new ones; pre-default consultations or post-default committee negotiations), restructuring terms should be subject to a

constructive dialogue focused on achieving a critical mass of market support before final terms are announced. Debtors should retain legal and/or financial advisors.

4. Fair Treatment

Avoiding unfair discrimination among affected creditors. The borrowing country should avoid unfair discrimination among affected creditors. This includes seeking rescheduling from all official bilateral creditors. In line with general practice, such credits as short-term trade related facilities and interbank advances should be excluded from the restructuring agreement and treated separately if needed.

Fairness of voting. Bonds, loans, and other financial instruments owned or controlled by the sovereign should not influence the outcome of a vote among creditors on a restructuring.

ANNEX II. Addendum To The Principles For Stable Capital Flows And Fair Debt Restructur ing[45]

This Addendum presents the recommendations of the Joint Public-Private Committee on Strengthening the Framework for Sovereign Debt Crisis Prevention and Resolution, endorsed by the Group of Trustees of the Principles on October 14, 2012, at its 2012 Annual Meeting in Tokyo. The Joint Committee was set up under the auspices of the Co-Chairs of the Group of Trustees in March 2012 to assess the recent experience with sovereign debt crisis prevention, management, and resolution in the Euro Area and elsewhere, draw appropriate lessons, and make recommendations on the strengthening of the existing framework for sovereign debt crisis prevention and resolution as embodied in the guidelines of the Principles for Stable Capital Flows and Fair Debt Restructuring. The recommendations included in the Addendum complement the Principles and provide amplification of the practical guidance for the implementation of the guidelines underlying the Principles to make them more practically relevant to the circumstances faced by mature market countries, including those that are members of currency unions.

1. Overall Assessment

The guidelines underlying the Principles for Stable Capital Flows and Fair Debt Restructuring remain an appropriate, relevant, and effective framework for sovereign debt crisis prevention and resolution. Their fundamental emphasis on sound policies and data and policy transparency by debtors is of critical importance in crisis prevention. Moreover, the underlying guidelines for voluntary, cooperative, market-based procedures for debtor-creditor dialogue and good-faith debt restructuring negotiations remain an essential cornerstone of sovereign debt crisis management and resolution and should continue to guide the interactions between sovereign issuers and their creditors. Such a cooperative approach would facilitate an early restoration of market access, which is of critical importance in achieving debt sustainability over time, and allow the official sector to gradually reduce its exceptional financial assistance to the countries under official sector-supported reform programs.

2. Data and Policy Transparency for Crisis Prevention

Sovereign debtors should pursue sound fiscal and growth-enhancing structural policies, consistent with macroeconomic and financial stability and public debt sustainability.

Sovereign debt issuers should ensure that they release on a timely basis comprehensive relevant data and other information related inter alia to their fiscal developments and debt positions (including, when appropriate, contingent liabilities) and on current and future policy plans. These data should be consistent with established accepted standards and norms (i.e. budget data should be released also on an accrual basis, not only cash basis) and verified by authorized domestic and regional agencies, especially with regard to their accuracy, comprehensiveness, and comparability over time.

Effective sovereign debt crisis prevention is a shared responsibility that requires—besides data and policy transparency and open dialogue with creditors by the sovereign debtors—sustained surveillance efforts by regional and international institutions and private sector groups, actions by regulatory agencies, accounting

[45] The Addendum to the Principles outlines the recommendation of the Joint Public-Private Committee on the Strengthening of the Framework for Sovereign Debt Crisis Prevention and Resolution, set up in March 2012 under the aegis of the four Co-Chairs of the Group of Trustees and the two Co-Chairs of the IIF Special Committee on Financial Crisis Prevention and Resolution to assess the recent experience with sovereign debt crisis prevention, management, and resolution in the Euro Area and elsewhere; draw appropriate lessons; and make recommendations for the strengthening of the existing framework for sovereign debt crisis prevention and resolution, as embodied in the guidelines of the Principles. The Group of Trustees endorsed the Addendum to the Principles at its Annual Meeting on October 14, 2012, in Tokyo, Japan. For the complete Joint Committee report and its recommendations, please refer to the 2012 Report on Implementation by the Principles Consultative Group.

and other international standard setters, as well as vigilance and enhanced risk management by private creditors and market participants in general.

The effectiveness and timeliness of surveillance by regional and international institutions of the consistency between policy plans and actual execution and of national policies with regional commitments and undertakings for countries that are members of currency unions are critical for promoting sustainable policies and market confidence. Clarity and transparency of information on actual economic trends and prospects are essential for facilitating effective risk management by market participants and efficient functioning of sovereign debt markets.

Private creditors and market participants are responsible for formulating accurate and appropriate assessments of underlying trends in market risks, and the credit and sovereign risks of individual issuers, thus ensuring a realistic pricing of sovereign debt instruments. In this context, private creditors and market participants should undertake their own due diligence, drawing inter alia on all available information from the sovereign issuers themselves and the assessments by regional and international financial institutions. The assessment of current economic and financial developments and the identification of underlying or emerging risks by private sector groups such as the IIF's Market Monitoring Group can also play a useful and constructive role in this process.

Regulatory agencies should take care in setting capital and other requirements for covered financial institutions to avoid distortions in market signals and biasing risk management practices.

Responsible and realistic assessments and timely analysis by ratings agencies can also provide useful complementary information to market participants, investors, and issuers and enhance crisis prevention.

3. Close Debtor-Creditor Dialogue and Cooperation for Crisis Prevention

Mature market country issuers should consider implementing the best practices for investor relations that have evolved. The adherence of emerging market borrowers to these best practices are reviewed annually by the IIF and summarized in the annual Implementation Report of the Principles issued by the Principles Consultative Group.

Enhancement of investor relations under Investor Relations Programs facilitates timely data and policy transparency and a regular dialogue between sovereign issuers and their creditors and establishes an effective channel of communication and feedback. The experience over the past few years has demonstrated the value and contribution of IRPs in enhancing market confidence and maintaining market access even during periods of market tensions and turbulence.

Sovereign debt issuers in both mature and emerging market countries should incorporate in new bond issues, denominated in a foreign or a common regional currency, CACs with appropriate aggregation clauses, with comprehensive coverage of their terms and conditions in the bond documentation and easy access to this information by all investors. Issuers of domestic bonds denominated in local currency may also consider such arrangements. Appropriately designed aggregation clauses would allow bond holders across all outstanding issues of government securities to collectively decide on whether to accept potential offers from issuers to modify existing bond terms and conditions. The use of CACs inclusive of aggregation clauses can facilitate voluntary debt restructuring by reducing the chances of a small minority of bond holders acquiring blocking positions in a bond series and imposing demands for preferential treatment.

4. Good-Faith Actions in Cases of Debt Restructuring

a. Voluntary Good-Faith Process

Good-faith negotiations remain the most effective framework for reaching voluntary debt restructuring agreements among sovereign debtors and their diversified private creditor community, particularly in the complex cases of mature market issuers that are members of currency unions. Such a framework has proved to be efficient in facilitating appropriate agreements on crisis resolution, while containing the adverse impact on market confidence and other disruptions and concerns caused by spillover and contagion risks. Sovereign issuers and their creditors should strive to reach and effectively implement voluntary agreements on a timely basis to help minimize adverse market reactions and contagion effects. In this context, debtors and creditors should be cognizant of the potential adverse effects of the interaction between sovereign debt and capital markets, to the detriment of the interests of all parties. With the increased sophistication, integration, and complexity of capital markets, for both emerging market and mature economy countries, the interaction between developments in sovereign debt markets, changes in the regulatory framework and banking system practices give rise to major dynamics with significant implications for credit expansion, risk practices, market access by sovereign debtors, and macroeconomic developments.

The dynamics and incentives for debtors and issuers to engage in good-faith negotiations are strongly influenced by the existing accounting and regulatory standards and their interaction across types of financial institutions and jurisdictions. The standard-setting bodies responsible for accounting and supervision rules, as well as the interpretation bodies, should be cognizant of the need to minimize inconsistencies between accounting and supervision practices and conflicts across jurisdictions and types of covered financial institutions.

The early restoration of market access is of critical importance in achieving debt sustainability over time. Early re-accessing of capital markets at reasonable costs is also essential for allowing sovereign debtors to reduce and eliminate their reliance on exceptional IMF financing and financial support from their official bilateral partners, such as is the case under currency unions or regional arrangements.

b. Debtor and Creditor Actions During Debt Restructuring

To facilitate good-faith negotiations, sovereign issuers, and regional institutions in case of regional arrangements, should engage in enhanced data and policy transparency and dialogue with their private creditors at an early stage, should a debt resolution become necessary. The early release of information on the scale of the adjustment needs and the range and scale of the envisaged corrective policies by the sovereign issuers themselves or in the context of adjustment programs supported by the IMF and/or regional institutions would help minimize adverse market reaction and contagion risks and facilitate continued or early resumption of market access. The sanctity of contracts should be respected. Modifications to these contracts should be avoided wherever possible as a matter of principle.

In the debt restructuring process, an early discussion is necessary between the representative private creditor committee and the sovereign debtor, in close consultation with the official sector, on the overall multi-year macroeconomic framework and objectives, including the broad fiscal policy targets and the underlying outlook for output growth and public debt under alternative assumptions on the debt restructuring. Such a discussion is important in facilitating an effective voluntary debt restructuring agreement on a fair burden sharing, thus promoting high private sector participation, restored market access, renewed output growth, and debt sustainability.

It should be recognized that the attainment of debt sustainability over time is a dynamic, complex process that depends critically on the quality and market credibility of actual and prospective adjustment policies

undertaken by the debtor, the direction of macroeconomic policies, the terms and volume of financial support or debt relief provided by official and private creditors, and the prospects for the continuation or resumption of market access at reasonable terms. As such, the debt sustainability analysis entails judgments and assessments that are often not easily amenable to quantitative rules and that require revisions as macroeconomic parameters evolve. The contributions toward achieving debt sustainability by private creditors as well as other creditors should be considered simultaneously, with no one creditor group considered as a residual source of funding on an ex ante basis.

In this context, the IMF has a very important role to play by providing objective analysis and information on macroeconomic policies and prospects and on the sovereign debtor's medium-term funding needs, consistent with debt sustainability considerations.

c. Creditor Committee Policies and Practices

Private creditors should organize themselves in a broadly based representative creditor committee as early as possible in the debt restructuring process, certainly before debt default, which should be avoided if possible. Sovereign issuers should interact and engage in negotiations with their private creditors through the representative creditor committee and should consult with the creditor committee as part of the process of fulfilling the requirement under IMF policy of lending to debtors in arrears to make good-faith efforts to reach understandings with their creditors. Such a framework would be more conducive to reaching a voluntary agreement on debt restructuring and facilitate market access.

Private creditors that are members of the creditor committee negotiating with the sovereign debtor should abide by established ethical standards and inter alia respect the confidentiality of any material non-public information that may become available during this process and notably commit not to use confidential information from the negotiations for trading purposes.

This process will be aided in cases of countries that require financial assistance from multiple official bilateral creditors, as is usually the case for countries that are members of currency unions, by the formulation of timely and effective procedures for reaching understandings on the scale, terms, and conditionality of any envisaged financial assistance from these creditors so as to facilitate the negotiations between the sovereign debtor and the private creditor committee.

In line with the evolving practice, the sovereign debtor would be expected to cover reasonable costs incurred by a single private creditor committee for the legal and financial advisor fees, consistent with agreed parameters.

d. Tools for Debt Restructurings

Sovereign issuers and their creditors should introduce CACs and possibly other options to enhance the credit quality of the new debt instruments used under debt restructuring exercises so as to enhance the prospects for high voluntary creditor participation. Retroactive legal changes to unilaterally modify the terms and conditions of financial contracts may undermine the integrity of financial markets and the sanctity of contracts and should be avoided.

However, in exceptional cases and after a voluntary debt exchange agreement has been reached, such modifications of the governing legal framework to introduce a collective action mechanism on a timely basis with terms and thresholds consistent with market practices may be necessary in facilitating a voluntary debt exchange and achieving a fair outcome for all bond holders.

5. Fair and Comparable Treatment of All Creditors

Sovereign issuers should treat fairly and provide comparable treatment to all creditors so as to avoid discrimination against any individual or groups of creditors. No creditor or creditor group should be excluded ex ante from participating in debt restructuring. Any exceptions to this principle should be discussed and agreed to among all creditors on the basis of adequate justification. Broad creditor participation in debt restructuring operations is essential to ensure a fair burden sharing, including the impact of the provision of new financial assistance, as well as to avoid any new or intensify existing subordination of the claims by some classes of creditors.

Fair treatment of all creditors is in the interest of both issuers and creditors. It lessens the burden on all creditors and, by avoiding discrimination, encourages creditors to participate voluntarily in debt resolution and minimizes any adverse impact on the investor demand for existing or new issues of sovereign debt by the issuer undergoing debt restructuring or similar debtors in the region or fellow members of currency unions. Reduced demand for sovereign debt by private investors, and/or delayed resumption of market access by the sovereign debtor due to subordination concerns, increase the potential burden on official creditors and international or regional institutions to provide financial support to the adjusting country in larger volume and/or over a longer period of time than would otherwise be necessary.

ANNEX III. Members Of The Group Of Trustees Of The *Principles*

Co-Chairmen

Mr. François Villeroy de Galhau
Governor
Banque de France

Dr. Yi Gang
Governor
People's Bank of China

Dr. Axel A. Weber
Chairman, Board of Directors, *UBS Group AG*
Chairman, *IIF*

Members

Mr. Tom de Swaan
Chairman of the Supervisory Board
ABN AMRO Bank N.V.

Mr. Alejandro Diaz de Leon
Governor
Banco de Mexico

Mr. Okyu Kwon
Former Deputy Prime Minister, Korea

Dr. Agustín Guillermo Carstens
General Manager
Bank for International Settlements

Nor Shamsiah binti Mohd Yunus
Governor
Bank Negara Malaysia

Mr. Jacques de Larosière
Honorary Governor, *Banque de France*
Former Managing Director, *IMF*

Mr. Jean-Claude Trichet
Honorary Governor, *Banque de France*
Former President, *European Central Bank*

Mr. Christian Noyer
Honorary Governor
Banque de France

Mr. Jaime Caruana
Board Member, *BBVA*
Former Governor, *Bank of Spain*
And Former General Manager, *BIS*

Mr. José Manuel González-Páramo
External Advisor
BBVA

Mr. Jean Lemierre
Chairman of the Board
BNP Paribas Group

Mr. Jordi Gual
Non-Executive Chairman
VidaCaixa

Mr. Mario Marcel
Governor
Central Bank of Chile

Mr. Jay Collins
Vice-Chairman, Banking, Capital Markets, Advisory
Citi

Mr. Walter Bayly
Chief Executive Officer
Credicorp

Mr. Nicholas Brady
Chairman, *Darby Overseas Investments Ltd.*
and Former Secretary, *U.S. Treasury*

Ms. Odile Renaud-Basso
President
European Bank for Reconstruction
and Development

Mr. Fabio Panetta
Member of the Executive Board
European Central Bank

Mr. Caio Koch-Weser
Chair, Advisory Council
European Climate Foundation

Mr. Gerd Häusler
Senior Advisor
Goetzpartners

Mr. Hans Humes
Chairman and Chief Executive Officer
Greylock Capital Management, LLC

Dr. Jacob A. Frenkel
Chairman, Board of Trustees, *Group of Thirty*
Former Governor*, Bank of Israel*

Ms. Antoinette M. Sayeh
Deputy Managing Director
International Monetary Fund

Mr. Timothy Adams (ex-officio)
President and CEO
Institute of International Finance

Dr. Christian Riken
Member of the Board of Managing Directors
Landesbank Baden-Württemberg

Dr. Ngozi Okonjo-Iweala
Director General, *World Trade Organization*
and Former Minister *of Finance, Nigeria*

Dame Nemat Shafik
Director
London School of Economics & Political Science

Mr. Wolfgang Schmidt
State Secretary
Ministry of Finance, Germany

Dr. Sri Mulyani Indrawati
Minister of Finance
Ministry of Finance, Indonesia

Mr. Charles Dallara
Advisory Partner
Partners Group AG

Dr. Zhou Xiaochuan
Former Governor
People's Bank of China

Dr. Zeti Akhtar Aziz
Group Chairman, *Permodalan Nasional Berhad*
Former Governor, *Bank Negara Malaysia*

Mr. Brian J. Porter
President and CEO
Scotiabank

Mr. Lesetja Kganyago
Governor
South African Reserve Bank

Mr. José Viñals
Group Chairman
Standard Chartered PLC

Dr. David Mulford
Distinguished
Visiting Fellow, The Hoover Institution
Stanford University

Mr. José de Gregorio
Professor, Departamento de Economía*,*
Universidad de Chile
Former Governor, *Central Bank of Chile*

Ms. Patricia Pollard
Deputy Assistant Secretary,
International Monetary and Financial Policy,
U.S. Department of the Treasury

Mr. James Valone
Senior Managing Director, Fixed Income
Portfolio Manager
Wellington Management Company, LLP

Mr. William Rhodes
First Vice Chairman Emeritus of the IIF Board
President & CEO
William R. Rhodes Global Advisors, LLC

ANNEX IV. Principles Consultative Group

Ms. Claire Husson-Citanna
Portfolio Manager
Abu Dhabi Investment Authority

Ms. Anne Milne
Managing Director, Emerging Markets
Corporate Credit Research
Bank of America Merrill Lynch

Mr. Lenin Duenas
Managing Director,
Head of Financial Institutions,
Corporate Banking, EMEA
The Bank of Tokyo-Mitsubishi UFJ, Ltd.

Ms. Kawtar Ed-Dahmani
Managing Director, Emerging Market Debt
Barings Asset Management

Mr. Charles Blitzer
Principal
Blitzer Consulting

Mr. Jean Lemierre
Chairman
BNP Paribas

Mr. Joe Beaulieu
Senior Economist
Brevan Howard

Mr. Michael L. Gerrard
Managing Director
BroadSpan Capital

Dr. Ksenia Yudaeva
First Deputy Governor
Central Bank of Russian Federation

Mr. Ulf-Peter Noetzel
Managing Director, Chairman of Trade Finance - Financial Institutions
Deutsche Bank AG

Mr. Lars Bane
Managing Member
Farallon Capital Management, L.L.C.

Mr. Nate Van Duzer
Managing Director
Fidelity Investments

Mr. Hans J. Humes
Chairman and Chief Executive Officer
Greylock Capital Management, LLC

Mr. Mark A. Walker
Senior Managing Director
Guggenheim Securities LLC

Mr. Edward Wilson
Head of International Development Unit
HM Treasury

Ms. Masha Gloukhovski
Managing Director, Head of Sovereign Advisory
JP Morgan Chase

Ms. Faouzia Zaaboul
Director of the Treasury and External Finance
Ministry of Economy and Finance, Morocco

Mr. Dominique de Guerre
Senior Advisor
Moelis & Company LLC

Mr. Spencer Jones
Managing Partner
Newstate Partners

Mr. Thomas Laryea
Counsel
Orrick, Herrington & Sutcliffe LLP

Mr. Chen Yulu
Deputy Governor
People's Bank of China

Mr. Joachim Fels
Managing Director, Global Economic Advisor
PIMCO

Ms. Jill Dauchy
Founder and CEO
Potomac Group

Mr. Terry Fryett
Executive Vice President, Chief Credit Officer, International Credit
Scotiabank

Ms. Marie-Christine Crosnier
Head of Sovereign Risks
Société Générale

Dr. Jérôme Jean Haegeli
Managing Director, Head Investment Strategy
Group Asset Management
Swiss Re Ltd.

Mr. Arend Kapteyn
Chief Economist
UBS AG

Mr. Christian Kopf
Managing Director
Union Investment Privatfonds GmbH

Mr. William Rhodes
First Vice Chairman Emeritus of the IIF Board
President & CEO
William R. Rhodes Global Advisors, LLC

ANNEX V. Members Of The PCG Working Group On Updating The Principles

Kevin Daly
Investment Director, Emerging Market Debt
Aberdeen Standard Investments

Yannis Manuelides
Partner
Allen & Overy LLP

Charles Blitzer
Principal
Blitzer Consulting

Jean Paul Debrinski
Senior Policy and Market Monitoring Officer
BNP Paribas Group

Deborah Zandstra
Partner
Clifford Chance

Madthav Patki
Managing Director, Head of EM Financing, EMEA, ITS
Credit Suisse AG

Lars Bane
Partner
Farallon Capital Management, L.L.C.

Mark Walker
Senior Managing Director
Guggenheim Partners, LLC

Leland Goss
Managing Director and General Counsel
International Capital Market Association

Thor Jonasson (observer)
Deputy Division Chief, Debt and Capital Market Instruments Division
International Monetary Fund

Elena Duggar
Chair of Moody's Macroeconomic Board, Associate Managing Director
Moody's Investors Service

Spencer Jones
Managing Partner
Newstate Partners LLP

Thomas Laryea
Of Counsel
Orrick, Herrington & Sutcliffe LLP

Christiaan van der Weerd
Governmental Affairs Advisor
UBS AG

Christian Kopf
Managing Director, CIO Fixed Income and FX
Union Investment Privatfonds Gmbh

Matthew Graves
Sovereign Analyst
Western Asset Management Company

Ian Clark
Partner
White & Case LLP

IIF

Paul Della Guardia
Financial Economist
Global Policy Initiatives

Sonja Gibbs
Managing Director and Head of Sustainable Finance
Global Policy Initiatives

Clay Lowery
Executive Vice President, Research and Policy

Khadija Mahmood
Economist
Global Policy Initiatives

Greer Meisels
Chief of Staff

Elizabeth Roberts
General Counsel

Emre Tiftik
Director, Sustainability Research
Global Policy Initiatives

ANNEX VI. IIF Best Practices For Investor Relations[46]

This section expands on the best practices developed in the Institute of International Finance (IIF) Action Plan of 2002. The best practices build on the key elements of the 2002 list. A central feature of a successful investors relations program (IRP) is the country's direct communication with market participants. The "Strengthened Investor Relations Best Practices" highlights the importance of formal communication channels between countries' authorities and market participants. In the countries' efforts to formulate market-informed macroeconomic policies, IR provides the opportunity to obtain investors' feedback in the formulation of economic policies. The new best practices also stress the need for continuous self-assessment. These best practices incorporate the following elements:

IRO/IR Staff

The Investor Relations Office (IRO) is the first and formal point of contact between market participants and authorities. It is a "one-stop shop" through which authorities can provide investors relevant data and information from the diversity of official sources, and investors can access relevant policymakers and provide policy feedback. It is important to have a designated IR officer, or IRO; however, the location of the office is not important (i.e., within the Treasury, Central Bank, or Ministry of Finance).

The job of the IRO staff is a dynamic one. The staff:

- Facilitate two-way communication channels with investors through emails, conference calls, and the IR website.
- Brief senior policymakers about market feedback and concerns, overall market sentiment with respect to asset class and general global environment, and anticipated market reactions to policy changes under consideration.
- Disseminate relevant macroeconomic data and policy information (see below) to market participants and answer questions about the data, information, and other related issues.
- Coordinate access of data and information from various official institutions and develop a network of officers in various government agencies and the Central Bank who can answer investor queries.
- Coordinate access of market participants to senior policymakers.
- Coordinate internally the country's "message" and convey this message to investors.
- Present a coordinated and streamlined message and explain any changes in policies or data.
- Maintain credibility by acknowledging weaknesses in policies and the economic situation at investor briefings but should not serve as an advertising campaign for the government.

Both corporate and sovereign IR officials have identified proximity to senior policymakers as one of the most crucial aspects of an IRO. Commitment by senior policymakers at the highest level is crucial to the effective functioning of an IRO. At the same time, it is important that the IRO and its staff be insulated from changes in the political environment.

The core staff should have an understanding of market practices as well as economic policies and should be able to articulate those to both policymakers and investors. Regular contacts with investors also help the IRO staff develop a "fabric of trust" and anticipate and reduce vulnerability to shifts in market perception. In addition, regular use of outside market sources should enable IRO staff to gauge investor perceptions and shape an effective communication strategy. As investor confidence begins to slip, more direct involvement of senior policymakers in the IR process may be required.

[46] The Strengthened Investor Relations Best Practices are presented in the report *Investor Relations: An Approach to Effective Communication and Enhanced Transparency-2005 Assessment of Key Borrowing Countries*, published by the Institute of International Finance in December 2005.

IR Website

All IRPs should have, as an essential component, a regularly updated, state-of-the-art website.

The IR website is a vehicle for providing relevant data and information to investors in a user-friendly format. It is a tool to most efficiently convey a country's policy objectives to the market with an option for seeking feedback and answering questions. It enables IRO staff to survey investors regarding future policy direction or to conduct self-assessments. To be effective, an IR website needs to present information simply and in a format that is well-organized, user-friendly, and easy to navigate. It should have the following components:

- Information on economic data and policies as defined below. These data should be in a format that can be manipulated by investors.
- Archived PowerPoint presentations or audio/video streaming of investor teleconferences or videoconferences.
- Links to websites for various official agencies and reciprocal links to their own website on those agencies' sites.
- Registration for investors who would like to be included in IR activities.
- Frequently asked questions (FAQs).
- Contact information for the IRO and relevant IR staff.

Dissemination of Macroeconomic Data and Policy Information

The IRO is responsible for coordinating and collecting market-relevant data and information to be disseminated to investors through the IR website or by email to an investor contact list. To be effective, the IR staff should execute this function using the following operating principles:

- **Timely and regular dissemination data releases and policy information**. Use a release calendar to notify the market of upcoming releases well in advance. This will help dispel market rumors that may emerge from lack of information.
- **Limited general information**. Rather, provide specific, tailored interpretations that give insights into the information. This is particularly important when the information is negative or during difficult circumstances arising from higher risk aversion by market participants or challenging domestic economic or political conditions.
- **Clear and user-friendly format**. Provide data in a Microsoft Excel format that can be manipulated, as opposed to providing PDF and Word formats. In addition, present data in a time series of at least two years, as opposed to just current data and previous period data. The highest level of "market-friendliness" is the ability for investors to specify parameters such as time period and currency to obtain tailor-made time series that can be downloaded into Excel. Quality data in categories most useful to the market are preferred over large quantities of data that are less useful. In terms of data provision, special efforts should be made regarding forward-looking information. The IRO should "defend" or explain forecasts provided in a timely manner. IROs should let investors know if there have been any changes in the technical definitions of data or revisions made to the data.

The following types of information—core statistics for fundamental economic analysis—should be disseminated regularly to investors through the IR website or to a comprehensive "investor list" via email notification:

- **Data on economic performance** based on the international data standards as they pertain to the International Monetary Fund's (IMF's) encouraged special data dissemination standard (SDDS). This requires timely provision of statistics of the real sector as well as of the fiscal, external, and financial sector statistics. These data should be supplemented as necessary by methodological notes. The IRO website should contain an indexed archive of the data or links to other government sites where the data are available.
- **Data for the 15 core indicators for financial sector soundness as identified by the IMF.** The IRO website also should contain an indexed archive of this information.

- **Forward-looking information on economic policies** such as budget projections, monetary policy targets, and structural factors (e.g., legal, regulatory, governance frameworks) supported by the data as appropriate. The IRO website also should contain an indexed archive of this information.

Additional Key Data

Market participants have highlighted the crucial importance of the availability of market-relevant data not currently prescribed by the SDDS but crucial for adequate economic assessment in three key areas: (1) central government operations, (2) central government debt, and (3) external debt. A detailed description of the encouraged and prescribed elements of these data is provided by the IMF and IIF standards.

- **Central government operations**. Tracking data for central government operations allows for a more timely analysis of a country's fiscal position than general government or public sector data.

- **Central government debt**. The assessment of debt sustainability is an integral feature of the country risk assessment. Disclosure of debt service schedules and currency breakdowns are needed to provide a more accurate picture of countries' future payment obligations. Countries also are encouraged to disseminate information that reflects liabilities of the central government in a comprehensive fashion and, where relevant, debt of other entities that is guaranteed by the central government. Disclosure of such information can help identify fiscal risks under different scenarios at an early stage.

- **External debt**. As demonstrated by previous crises, a country's debt profile can influence its resilience to external shocks. The availability of assets and liabilities of the private and public sector held by non-residents provides a picture of potential balance sheet vulnerabilities in domestic sectors. To carry out an adequate assessment of a country's international position, investors attach importance to the availability of non-resident holdings of private and public debt issued domestically as well as the resident holdings of external debt issued internationally.

IR Contact List

The IRO should develop and maintain a comprehensive list of contact information for investors, analysts, rating agencies, and other market participants who regularly track the country. This list should be supplemented with contact information for institutions that have key relationships with local financial institutions. The list should be maintained regularly and can be enhanced to target specific investors, if appropriate. Countries should maintain comprehensive contact lists so that they know, at any given time, who their investors are and so can evaluate how certain types of creditors will behave during times of vulnerability.

Feedback and Communication Channels

Feedback mechanisms are essential to foster two-way communication between investors and policymakers. Formal, regular channels should be created for responding to questions from investors, encouraging feedback about concerns, and communicating this information to key policymakers to enable them to make market-informed policy decisions.

These channels could be established through:

- Teleconferences or webcasts with investors.
- Bilateral meetings between investors and senior policymakers.
- Phone or email contacts via the IRO.
- Interactive deal/non-deal roadshows.

Teleconferences or Internet-based webcasts should be led by senior "decision makers" such as the undersecretary of finance or deputy governor of the Central Bank and can be moderated by the head of the IRO. Teleconferences/webcasts on key economic data and policies should be conducted on a quarterly basis, at a minimum. In addition, issue-oriented conference calls that are not part of the regular framework can help address questions and dispel rumors related to specific events or policy decisions.

Investors should be alerted about upcoming teleconferences/webcasts via email and should be provided with relevant information in advance to facilitate feedback and questions and to enable policymakers to focus on key issues. Policymakers should understand and communicate in the "language" of the investor community. Presentations should be uncomplicated and "forward-looking." Teleconferences and webcasts should be recorded for replay, and any associated material provided in advance to investors should be archived on the IRO website. To provide a level playing field, policymakers should provide the same information to all investors.

Investors value face-to-face interaction with senior policymakers through bilateral meetings. They should be able to directly contact **IRO staff via email or phone** to ask specific questions or to arrange meetings with senior policymakers. If the IRO staff is unable to process the request directly, it should coordinate with counterparts in other government agencies, ensuring that it can respond to investors in a timely manner. Non-deal roadshows to key financial capitals (conducted on a semi-annual basis or as opportunities arise) also are an important tool to foster dialogue. High-level interactions become even more important when a country faces difficult times.

Times of Diminishing Market Confidence

Issuers who support the Principles agree that countries accustomed to dealing proactively with market participants will have a head start in stepping up the consultation process with market participants in response to signs of eroding market confidence. Such swings in market sentiment may be attributed to challenging economic and political prospects or contagion from developments in other emerging markets.

As market confidence begins to diminish, authorities should intensify consultations with market participants. IR staff can help deflect contagion by providing investors with a better understanding of policy goals and prospects, respond to investor inquiries, and in effect help investors differentiate among countries within the same asset class. IRO staff are capable of independently responding to contagion risk, in contrast to government polices put in place under challenging conditions that require the support of their authors. In cases where challenging domestic conditions exist, the involvement of senior policymakers in the IR process is essential to adding credibility to policies. Under these circumstances, policymakers at the most senior level should make exceptional efforts to help alleviate market uncertainty by explaining the rationale of economic measures undertaken and demonstrate their preparedness to take market feedback into account when formulating additional action. The frequency of economic data and policy information provided to investors should be maintained or intensified—not reduced.

Teleconferences or webcasts with investors should become more frequent and led directly by finance ministers, Central Bank governors, or other senior policy officials as necessary. In such circumstances, an appropriate tool for engaging in a direct dialogue with investors may be through interactive non-deal roadshows in key financial capitals. The roadshow should be conducted by senior policymakers from all appropriate official agencies.

Regular Self-Assessment

IROs should conduct annual assessments to ensure they are providing the best possible services to policymakers and investors, including providing timely, accurate, and relevant information, reaching all targeted investor groups, receiving and effectively processing feedback, and using the most optimal technology to reach out to investors. IRO staff can conduct self-assessments or use outside consultants such as the IIF's Sovereign Investor Relations Advisory Service (SIRAS). Investor surveys on the IRO website or to the investor contact list also would be useful. To be effective, IRO activities can be benchmarked against IIF IR best practices or other guideposts, such as corporate IRO best practices.

Press and IR

Several authorities have explored co-mingling press and IR functions in a single IRO. While the thrust of these functions is similar, as they both involve communicating with the external environment, the key differences between them provide convincing arguments that they should be kept separate.

- **Audience**. IR staff must deal daily with market participants who track a country's economic performance and policies on a regular basis. These investors and creditors are sophisticated in their knowledge, and they demand specific detail about the environment and outlook for economic policies and data. The press, on the other hand, is more interested in "big-picture" information that would appeal to its own audience rather than in technical details.

- **Content**. Investors require market-relevant information or data on economic policies that conform to international standards, forward-looking information on economic policies such as budget projections and monetary policy targets, and information on legal and regulatory frameworks. This information must be tailored to reflect the different requirements of various investor groups, such as bondholders, in both domestic and international capital markets, as well as equity investors. Press content focuses more on broad issues related to economic policy or political developments that do not require technical explanation or a detailed understanding of policy formulation.

- **Staff**. The skill set of IR staff differs significantly from that of press relations staff. Most importantly, to effectively communicate with market participants, IR officers must be able to speak in the language of the market (i.e., have an in-depth technical understanding not only of a country's economic performance and policies but also of how markets operate). They must be able to answer investor queries and provide market feedback to senior policymakers. While press relations staff must have a basic understanding of economic performance and policies, their skills should mostly be focused on public relations and dealing with press contacts, as well as "managing" both positive and negative political developments.

ANNEX VII. Executive Summary—IIF Best Practices For Formation And Operation Of Creditor Committees

1. Introduction

The best practices for efficient and effective debtor and creditor engagement, including the formation and operation of Creditor Committees are based on extensive discussions among members of the IIF's Sovereign Risk Management Committee and the Principles Consultative Group, including stakeholders representing both debtors and creditors. Additionally, these best practices have been broadly endorsed by the Group of Trustees. The Group of Trustees, as guardian of the Principles for Stable Capital Flows and Fair Debt Restructuring, consists of senior officials from both advanced and emerging market economies and senior bankers and investors involved in advanced and emerging markets finance, many of whom have participated in the formulation of the Principles. The Principles recommend the use of Creditor Committees in cases in which a debtor defaults on its debt to private creditors and investors and also in the early stages and during periods of diminished market access when debt restructuring or reprofiling is deemed unavoidable. In fact, the key advantage of Creditor Committees for debtors has been that endorsement of the terms of a debt restructuring by the Committee signals acceptability of the deal to the wider creditor community and ensures the support of a wider "critical mass" of creditors and investors. Such support can play a vital role in reaching the requisite majority voting thresholds required by collective action clauses in sovereign bond contracts and especially in the context of the aggregated CACs, published by ICMA in 2014, which the IIF supports, where a collection action mechanism is activated in a sovereign debt restructuring proposal.

The Principles provide general guidelines that lay the basis for a voluntary, good-faith debt restructuring process. Paramount among these guidelines is the notion of good-faith negotiations between a debtor and its creditors; the Principles put these two parties at the center of the negotiation process. The Principles recognize the sovereignty of the debtor while upholding the sanctity of contracts during debt restructurings.

2. Creditor Engagement Best Practice Principles

1. Initial Formation

The initiative of forming a Creditor Committee can be taken through various approaches: the debtor can ask for a Committee to be formed – this has occurred in a few cases; the debtor and its creditors and investors (hereafter called "the creditor community") agree to form a Committee – this has been the most common case; or the creditor community initiates the formation of a Committee that reflects their interests.

In case multiple committees are formed thought should be given to whether it would be beneficial to form a single steering committee to interface directly with the debtor, particularly where the multiple committees represent substantially similar asset classes.

2. Cooperation and Trust

For the negotiations to proceed in an orderly manner, an element of trust must be developed between the debtor and the members of the Committee, as well as among Committee members themselves. Effective engagement requires the debtor, and the creditor community to cooperate in the formation of the Committee. It is thus important to be aware of certain sensitivities a debtor may have regarding individual creditors and investors. The issue of fees and potential endorsement of any proposal in due course should be discussed.

3. Diversity of the Creditor Community

The Committee should consist of creditors and investors who can reflect the interests of the range of members of the creditor community affected in the negotiation process, encompassing, among other things, not only financial instruments and investment strategies but also regional differences. The Committee should hold or represent a substantial number of claims and include a diverse set of creditors and investors.

4. Speed of Process

Experience shows that delay may significantly increase the cost or risk the failure of a restructuring. There should be a presumption that speed is of the essence and this principle should guide all processes including internal coordination and discussions.

5. Confidentiality

Parties should agree on a protocol for managing confidential information including implementing Chinese Walls or similar measures to manage material non-public or confidential information that is shared in the context of a restructuring negotiation.

IIF BEST PRACTICES FOR FORMATION AND OPERATION OF CREDITOR COMMITTEES

1. INTRODUCTION

The best practices for the formation and operation of Creditor Committees are based on extensive discussions among members of the IIF's Sovereign Risk Management Committee and the Principles Consultative Group. Additionally, these best practices have been broadly endorsed by the Group of Trustees. The Group of Trustees, as guardian of the Principles for Stable Capital Flows and Fair Debt Restructuring, consists of senior officials from both advanced and emerging market economies and senior bankers and investors involved in advanced and emerging markets finance, many of whom have participated in the formulation of the Principles. Both groups have been engaged in both encouraging and monitoring the practical application of the Principles through assessments of a variety of country cases. Their input has been important in the shaping of these best practices in order to encourage participation from debtors and creditors who support the Principles. The Principles recommend the use of Creditor Committees in cases in which a debtor defaults on its debt to private creditors and investors and also in the early stages and during periods of diminished market access when debt restructuring or reprofiling is deemed unavoidable. In fact, the key advantage of Creditor Committees for debtors has been that endorsement of the terms of a debt restructuring by the Committee signals acceptability of the deal to the wider creditor community and ensures the support of a ”critical mass“ of creditors and investors. Such support can play a vital role in reaching the requisite majority voting thresholds required by collective action clauses in sovereign bond contracts and especially in the context of the aggregated CACs published by International Capital Market Association (ICMA) in 2014; allowing the aggregation of multiple series of debt securities for the purposes of voting in respect of a restructuring proposal, which have been welcome by the G-20, the IMF and the IIF, among others.

The best practice principles for the formation and operation of Creditor Committees are based on established practices of the traditional London Club and adapted to the world of capital markets. As such, these principles aim to reflect the impact securities laws may have on both the Committee's operations and creditor-debtor interactions. They also reflect experience gained in corporate restructurings.

It is import to stress that negotiations in good faith should remain the essence of debt restructurings. A move away from good-faith negotiations between issuers, creditors and investors on the basis of a limited number of exceptions is inconsistent with the international understandings that have been historically at the heart of sovereign debt restructurings. The need for such negotiations between the parties is increased and even more significant if the requisite thresholds envisaged under the aggregated CACs are to be met and the sovereign is to benefit fully from the enhanced collective action mechanism.

2. THE ROLE OF GOOD-FAITH NEGOTIATIONS AND CREDITOR COMMITTEES IN THE PRINCIPLES

General Guidelines for Sovereign Debt Restructurings

The Principles provide general guidelines that lay the basis for a voluntary, good-faith debt restructuring process. Paramount among these guidelines is the notion of good-faith negotiations between a debtor and its creditors; the Principles put these two parties at the center of the negotiation process. The Principles recognize the sovereignty of the debtor while upholding the sanctity of contracts during debt restructurings.

Good Faith

The *Principles* place great importance on good- faith negotiations as a key element of the debt restructuring process. They call on creditors and debtors to ”engage in a restructuring process that is voluntary and based on good faith. Such a process is based on sound policies that seek to establish conditions for renewed market access on a timely basis, viable macroeconomic growth, and balance of payments sustainability in the medium term.” The Principles add that ”debtors and creditors agree that timely good-faith negotiations are the preferred course of action toward these goals, potentially limiting litigation risk.” Such negotiations are thus at the heart of the restructuring process, including through the operation of Creditor Committees.

However, it is very difficult to come to a precise definition of ”good faith“ and it is neither wise nor practical to seek an exhaustive set of criteria to evaluate this principle. We agree that, rather than defining the principle itself, the most productive approach is for any participant in the negotiation process to indicate when it believes that actions of another party have not been conducted in good faith.

Creditors and Debtors at the Center of the Negotiation Process

As a joint product of issuers and investors, the Principles maintain that the final result of the restructuring process should be obtained through cooperative interaction between the debtor and its creditors. The Principles also maintain that ”regardless of the specific restructuring mechanics and procedures used (i.e., amendment of existing instruments or exchange for new ones; pre-default consultations or post-default committee negotiations), restructuring terms should be subject to a constructive dialogue focused on achieving a critical mass of market support before final terms are announced.”

Sovereignty of the Debtor

The Principles recognize the sovereign nature of the debtor. They emphasize the importance of putting a country back on a sustainable economic path, while preserving and protecting asset values during the restructuring process. At the same time, they also uphold the sanctity of contracts between sovereign debtors and creditors, stating that, ”subject to their voluntary amendment, contractual rights must remain fully enforceable to ensure the integrity of the negotiating and restructuring process.”

The Role of Creditor Committees in the Principles

The *Principles* support debtor-creditor negotiations as the preferred way forward in cases which require a debt restructuring. They also articulate the role of Creditor Committees in such negotiations, especially in cases of default.

Under the sub-principle ”vehicles for restructuring“ the Principles state,
”The appropriate format and role of negotiation vehicles such as a creditor committee or another representative creditor group (hereafter referred to as a ”creditor committee“) should be determined flexibly and on a case-by-case basis. Structured, early negotiations with a creditor committee should take place when a default has occurred in order to ensure that the terms for amending existing debt contracts and/or a voluntary debt exchange are consistent with market realities and the restoration of growth and market access and take into account existing CAC provisions. If a creditor committee is formed, both creditors and the debtor should cooperate in its establishment.”

If a Creditor Committee is formed, the Principles provide guidelines in order to enhance its effectiveness. They stipulate that Creditor Committees ”*should*:

- *Adopt rules and practices, including appropriate mechanisms to protect material non-public information;*
- *Coordinate across affected instruments and with other affected creditor classes with a view to form a single Committee;*
- *Be a forum for the debtor to present its economic program and financing proposals;*
- *Collect and analyse economic data;*
- *Gather, evaluate, and disseminate creditor input on financing proposals; and*

- *Generally act as a communication link between the debtor and the creditor community."*

In October 2004 the International Primary Market Association (IPMA)1 released standard collective action clauses for fiscal agency agreements under English law that also contained provisions for the appointment of a Noteholders' Committee. This provision was updated in 2014 for use across issuances in conjunction with the new ICMA standard aggregated CACs and, following further broadly based consultations, were further revised in 2015. The updated Noteholders' Committee provisions allow the aggregation of debt across multiple series of debt securities to meet the requisite threshold to form a committee, and, in instances where multiple creditor committees are formed, require that a simple steering committee interfaces directly with the debtor. These contractual provisions written in times of normal market access should help to guide the process at other times (including a time of crisis) and thereby facilitate sovereign debt restructurings further. Their take up has, thus far, however, not matched the adoption of the aggregated CACs in sovereign bonds issued since their publication.

In practice, however, a Creditor Committee can be formed at the time of need whether or not a creditor engagement provision is included in the underlying debt contracts. With this in mind the best practice principles which follow are valuable both in cases where there is an underlying creditor engagement clause and where there is no such provision.

3. BEST PRACTICE PRINCIPLES FOR CREDITOR COMMITTEES

1. Key Concerns Regarding Creditor Committees

Over the past few years, establishing Creditor Committees has faced certain hurdles. On the one hand, debtors have, in some cases, objected to recognizing Creditor Committees for various reasons: either because they were not involved in the formation of the Committee; had reservations regarding certain Committee members with whom they did not want to negotiate; questioned the Committee's representativeness; or because they simply did not want to negotiate with creditors and investors, preferring to do so bilaterally or not at all. On the other hand, some members of the creditor community have been reluctant to join Creditor Committees if they saw it as constraining their range of options or they have not been able to because they have not had the corporate structures which would allow them to participate.

On the sovereign side, there has also been some reluctance to accept to pay the costs of the Creditor Committee and a desire that the good faith negotiation requirement should apply to creditors as well as debtors.

Perceptions by some issuers that the Committee process is slow-moving and causes delay in the resolution of a debt problem have also been cited as a reason that they have favored a unilateral approach. When considering such an approach, issuers should be aware that refusal to negotiate may result in low participation and expensive lawsuits, and as a result possible constraints on market access.

Much of the debate has centered on the issue of "representativeness" of a Creditor Committee. In some cases, issuers' legal advisors have questioned whether Committee members have secured mandates from other members of the creditor community in order to represent them. Such a request goes against the grain of reality, however. Historically, members of Creditor Committees have not formally "represented" other creditors and investors but they have reflected the views of the creditor community during the negotiations with a view toward attracting a critical mass of support for negotiated restructuring terms. In a small number of cases, a group of creditors and investors, in particular fund managers, have appointed a representative to the Committee to negotiate on their behalf.

Representativeness has also been interpreted to mean sufficient diversity of creditors and investors. Diversity in turn has caused concerns in some quarters that Creditor Committees are cumbersome to deal with, especially since different members of the creditor community may have divergent interests because they may have purchased credit default swaps or other protections, or because they may have acquired

instruments on the secondary market and thus are not original holders.
In today's market, a Committee having a diversity of creditors and investors is likely to mean having banks, fund managers, hedge funds, and retail investors either represented and/or directly involved. However, debtors have objected that some types of creditors and investors who would need to have representativeness are not capable structurally of maintaining the needed confidentiality and obeying the applicable insider trading rules.

While confidentiality was protected by unwritten rules in the 1980s and 1990s, today's world of securities offerings has set higher standards.

One issue relates to the type of information a debtor can release ahead of an offering. (Unregistered offerings are speedier and lower cost options but the release of the "wrong" type of information may delay or prohibit the debtor from proceeding with an unregistered form, and instead a registered offering may be required.)

The other issue is that securities laws (in most jurisdictions) preclude trading on non-public material information, and a Committee is likely to come in contact with such information. This is a concern for creditors, investors, and debtors. For creditors and investors, the "stop trading" rules of some previous restructurings are not feasible. For the debtor who may bear many of the negative consequences of information leaks and insider trading, a "no trading" rule may be preferred for Committee members.
As a possible solution, a "code of conduct" has been used in a few cases in the sovereign context but cues have been taken in particular from corporate restructurings. Such a code is an agreement between the debtor and the Creditor Committee on a range of issues. It imposes simple restrictions on confidential information on both sides and offers more flexibility on trading for Committee members who commit to complying with insider trading rules.

The best practice principles articulated below address these key concerns as well as other issues with the aim to develop a better basis for Creditor Committees to be acceptable to issuers and protect the rights of creditors and investors.

2. Creditor Committee Best Practice Principles

A. Initial Formation

The initiative of forming a Creditor Committee can be taken through various approaches: the debtor can ask for a Committee to be formed – this has occurred in a few cases; the debtor and its creditors and investors (hereafter called "the creditor community") agree to form a Committee – this has been the most common case; or the creditor community initiates the formation of a Committee that reflects their interests.

If multiple creditor committees are formed, in order to make the process as efficient as practicable, thought should be given to whether it would be beneficial to form a single steering committee to interface with the debtor. Where there is considerable diversity in the asset classes represented by different committees, the formation of a single steering committee may not be as beneficial as it would be in instances where multiple committees represent substantially similar asset classes.

B. Cooperation and Trust

1. In order for the negotiations to proceed in an orderly manner, an element of trust must be developed between the debtor and the members of the Committee, as well as among Committee members themselves.

2. The Principles call on the debtor and the creditor community to cooperate in the formation of the Committee. It is thus important to be aware of certain sensitivities a debtor may have regarding individual creditors and investors.

3. It is also important for there to be an open discussion concerning who should meet the reasonable costs, including legal and financial advisory fees, incurred by the Committee.

4. The parties should also discuss the issue of endorsement of the terms of a debt restructuring to be given at the end of the negotiation process. To the extent the Committee agrees with the terms of a debt restructuring it should seek to signal support for the proposal, to the extent possible. There may be instances where unanimous support of the Committee cannot, despite good faith negotiations, be obtained. In such instances, it should be understood that the debtor should not feel precluded from bringing its restructuring proposal to the market nevertheless, especially if it believes there is significant support for it.

C. Diversity of the Creditor Community

1. The Committee should consist of creditors and investors who can reflect the interests of the range of members of the creditor community affected in the negotiation process.

2. Diversity of Committee members should encompass not only financial instruments and investment strategies but also regional differences. The latter is particularly useful in order to consider differential tax treatments and regulatory differences that may help design options to facilitate the participation of the creditor community in different jurisdictions in the restructuring.

3. In order to facilitate participation by hedge funds and asset managers who may face conflicts of interest when they come into contact with material non-public information or other constraints (staffing, for example), consideration could be given to appointing an external representative. Such an individual should have appropriate restructuring experience (as described below) and operate under his terms of reference. This representative would be bound by confidentiality parameters (see below) and would provide only the necessary information that his clients need in order to make decisions regarding the restructuring negotiations.

4. The Committee should be of a manageable size, but Committee membership should not be limited only to ”large“ creditors and investors. At the same time, the Committee as a whole should at all times hold or represent a substantial amount of claims and should include a diverse set of creditors and investors (see ”Diversity“ above).

5. A Committee must have credibility with the debtor and be able to signal that it has influence with a critical mass of all creditors and investors although as a legal matter the Committee will not be able to bind holders of the debtor's debt securities in any event, acceptance or not of a proposal will be based on participation by such holders in an exchange offer and/or voting rights being exercised as part of a collective action mechanism, for example. To the extent, however, that the Committee would wish to discuss matters of internal ongoing administration following its establishment, the Committee should not need to act by unanimity in respect of any decisions to be taken.

6. The debtor and the Committee must be prepared to discuss the relative contribution, by way of debt relief or otherwise, of other creditors, such as bilateral and multilateral creditors: in the context of any debt sustainability analysis underpinning the restructuring discussions.

D. Speed of Process

3. The creditor community should work closely with the debtor toward the formation of the Committee, recognizing that this process can be initiated through different channels. There should be a presumption that speed is of the essence.

4. Creditors and investors should consider approaches to internal coordination that expedite rather than delay the process.
5. Creditors, investors and the debtor should agree on the negotiation process that should be followed, including the nature and sequence of the discussions. Such an understanding, which of course should not delay the actual negotiations, could help inform the IMF, for example if judgments on

lending into arrears need to be made.

6. Committee members should take into account the time commitment they must set aside from their day-to-day work in order to participate in restructuring negotiations. To ensure continuity, it is important that a particular creditor or investor be represented by the same individual throughout the restructuring process.

7. Effective Committee leadership will be key to ensuring an efficient Committee process.

E. Confidentiality

1. The members of the Committee, the debtor, and advisory firms should consider agreeing on and signing a ”code of conduct.”

2. Any information not already in the public domain would be considered confidential.
3. Under the code, parties would agree to refrain from disclosing confidential information to anyone other than a list of related parties (provided they also subject themselves to the code) unless required by law.

4. Under the code, parties could issue periodic press releases that comply with applicable securities law to ”share information with the market.” Information would not be released that either ”conditions the market“ for an offering or that could be seen as deceptive.

5. Legal advisors to parties should advise on what information can be released.

6. Committee members should implement Chinese Walls or similar measures to ensure that those who make trading decisions are not in the possession of confidential information that is shared in the context of a restructuring negotiation.

7. Negotiations should take place directly between the debtor and creditors, without the participation of multilateral or bilateral organizations, unless their participation or presence is requested by either the debtor or the creditors, and the other side agrees to such a request.

8. Both debtor and creditors should avoid commenting on the negotiations, especially whist these are ongoing, as this could undermine trust and also result in price sensitive information leaking into the capital markets and affecting the price of the debtor's securities.

F. Restructuring Experience

1. The ”tool kit“ of at least some of the Committee members' experience should include practical skills in sovereign and/or non-sovereign restructurings.

2. Creditors and investors who are new to the asset class should not be excluded for lack of experience, in particular if their claims are substantial.

3. Committee members should consider the feasibility of particular restructuring proposals they aim to advance with the debtor.

G. Legal Advisors

1. The law firm representing the Committee should have ample debt restructuring experience.

2. If the firm has business relationships with Committee firms, in particular those with sizable shares of the outstanding debt, potential conflicts of interest should be addressed internally.

H. Logistical Support

1. Committee members should share responsibilities for providing facilities and staff to arrange meetings and for handling communications with the debtor as well as other members of the creditor community not on the Committee.

2. The clearing systems should be leveraged as a communication tool particularly in cases in which a substantial amount of debt is held at the retail level.

This report is published by the Institute of International Finance, Inc.
1333 H Street, N.W., Suite 800E, Washington, D.C. 20005-4770
Tel: 202-857-3600 | www.iif.com | @iif
October 2021