PRINCIPLES FOR STABLE CAPITAL FLOWS AND FAIR DEBT RESTRUCTURING IN EMERGING MARKETS

REPORT ON IMPLEMENTATION
BY THE
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TRANSPARENCY COOPERATION GOOD FAITH FAIR TREATMENT

Overview

Over the past year, the global environment has changed at a rapid speed as both new trends and new strains have emerged. The Principles have proven to be of continued if not increased relevance in this changing global environment. The market turbulence witnessed in August and subsequent fallout has solidified the importance of having good communication among and between market participants and authorities. A reemergence of market strains in recent months fueled by a heightened level of uncertainty underscores the need for more and better information and transparency, particularly with the increasing complexity of financial instruments and investment vehicles. In these circumstances, the adaptability of the Principles has become a proven source of strength as they are based on a flexible framework covering the core pillars of transparency, dialogue, good faith and fair treatment.

Support for the Principles is exemplified by the broad participation and rich discussion at a roundtable discussion in Washington on Deepening Access to International Capital Markets: The Roles of Issuers and Investors. Senior officials from 15 emerging market countries and a number of leading industrial countries, senior IMF management, and leaders from the private creditor and investor community participated in the discussion. The audience included officials from a range of countries, including Brazil, Chile, Hungary, Indonesia, the Philippines, South Africa, and Turkey, as well as a diverse group of market participants from investment banks, hedge funds, pension funds, and other institutional investors.

Several participants underscored their strong support for the Principles, and applauded the progress that has been made by issuers and investors in adopting the Principles. The exemplary cooperation between emerging markets and the private sector, including through the G-20, was commended. Market participants from both developed and emerging market economies observed that the voluntary, market-based Principles are flexible and particularly well suited for framing cooperative action for crisis prevention and resolution in today's fast-changing environment. The Principles are fully aligned with today's evolving global environment and clearly articulate the responsibilities of those engaged in emerging markets finance.

It is clear that the Principles have provided value to all parties involved in the implementation process. The Principles have helped to reduce surprises in the market, increase predictability of borrower's and creditor's actions, and have contributed to smooth resolution of crises. The value offered by the Principles has become particularly evident after periods of global market volatility. The Principles Consultative Group (PCG) process has given participants a practical set of tools and a forum for discussion through which to assess partner's behavior. For example, borrowers have been made better aware of the expectations of the market, including the need for transparency, communication and sound policies. Moreover, the Principles have been significant guideposts for action at a time when vulnerabilities have emerged and have provided a compass for policymakers and investors alike.

Sovereigns recognize the importance of investor relations and data transparency in light of the increased role played by private flows in today's environment for emerging markets. It has become evident that crisis prevention and crisis resolution overlap. One of the key pillars of the Principles–transparency–is essential to crisis prevention. Crisis prevention is the first line of defense when facing financial turbulences. The application of the Principles in 2007 has served to bring about further improvements in transparency as well as communication among market participants. The effectiveness of the Principles in this regard has taken on added significance in the aftermath of recent market turbulence.

Market developments this year further underscore the value of following a predictable approach and operating in good faith. Emerging markets have seen an increase in foreign investors in local capital markets. Investor relations and data transparency, cornerstones of the Principles, are applicable to this new market trend. In fact, the presence of foreign investors expands the data needs of market participants to make informed risk management decisions with respect to local capital markets.

As the Principles have become imbedded in the fabric of the global financial community, synergies between the PCG and international financial institutions have become more obvious and are being utilized. At the broadest level, the Principles have supported and facilitated the accomplishment of the IMF's goals to promote international monetary cooperation and have helped enhance stability of the international financial system. In addition, the Principles have provided further momentum to the IMF's efforts to improve data transparency, encourage sound policies, and facilitate cooperative solutions to debt restructurings when they arise. At the practical level, the PCG process has already offered supplemental guidance to those seeking access to capital markets following a debt restructuring and sound advice to those contemplating possible debt payment interruption.

As crisis resolution has become more complicated because of the increasing diversification of the emerging market investor base, the flexible and adaptable approach of the Principles has provided the market with an effective means to resolve problems. Moreover, the Principles can be a valuable tool to help quell market volatility and promote the resiliency of emerging markets.

Benefits of Implementing the Principles

The Principles' overriding strength is that they incorporate voluntary, market-based, flexible guidelines for behavior and actions of all parties which have been framed cooperatively by debtors and creditors. The main benefit for the system as a whole is their proactive and growth-oriented focus, given that the Principles are operative not only after a crisis has occurred but mainly during times of diminished market access and early crisis containment.

The Principles also yield substantial shared benefits for emerging market issuers, creditors, and investors. They can reduce vulnerabilities to economic or financial crises, as well as their frequency and severity, by promoting:

- Information sharing and close consultations between debtors and their creditors and investors to provide incentives for sound policy action in order to build market confidence.

- Enhanced creditor-debtor communication by encouraging debtors to strengthen investor relations based on market best practices and investors to provide feedback. Investor relations practices help enable policymakers to make market-informed policy decisions.

- Early corrective action through sound policymaking stimulated in some cases by intensified investor relations or based on direct consultations between the debtor and its creditors and investors.

- Cooperative behavior between debtors and creditors toward an orderly restructuring based on engagement and good faith negotiations toward a fair resolution of debt-servicing difficulties. Such actions could accelerate a country's restoration of economic growth and market access.

Through these cooperative actions, the Principles can underpin a sustainable and healthy flow of private capital to emerging market economies, facilitating needed investment for long-term growth.

Implementation of the Principles

The implementation process is based on the cooperation and partnership between issuers and investors that was formed during the creation of the Principles. It is operationally centered on the PCG with technical support from the IIF secretariat. In addition, a Group of Trustees, comprised of senior leaders in global finance, provides overall guidance for the implementation of the Principles and lends credibility and objectivity to this process.

The PCG consists of 21 finance and central bank officials from emerging markets and senior representatives of the private financial community, many of whom were instrumental in the formulation of the Principles.

The implementation process has four main functions:

- Evaluate how implementation is proceeding both on the issuer and the investor side;

- Facilitate the development of a continuous effort by issuers and investors to keep each other abreast of developments in emerging markets and encourage sound policies and investor support;

- Offer guidance for the restructuring process in appropriate cases; and

- Help ensure the continued relevance of the Principles in light of changing characteristics of international capital and credit markets.

Against the backdrop of the general environment for emerging markets, the purpose of the PCG is to:

- Consider specific country circumstances with a view toward providing suggestions to authorities and creditors as to how to align their policies and actions better with the Principles.

- Evaluate a wide range of country cases, including those where significant progress has been made as well as others that are facing market difficulties.

- Review market trends and the changing characteristics of capital and credit markets in order to ascertain if the Principles remain relevant or require amendment. Such reviews will be generally completed ahead of the annual meetings of the Group of Trustees.

The PCG is supported by the IIF which acts as a secretariat. The IIF consults with members of the PCG as well as other market participants as to which countries should be included in PCG discussions. It also prepares background material for PCG calls, providing analysis of investor relations and data transparency practices as well as economic policies of countries on the agenda. Staff from the IMF's Policy Development and Review Department and Monetary and Capital Markets Department as well as a representative from the Federal Reserve Bank of New York join PCG discussions as observers.

The Group of Trustees is comprised of current and former leaders in international finance with exceptional experience. The Group is co-chaired by Mr. Jean-Claude Trichet, President of the European Central Bank; Mr. Henrique de Campos Meirelles, Governor of the Central Bank of Brazil; and Mr. Toyoo Gyohten, President of the Institute for International Monetary Affairs in Tokyo, a former Japanese Vice Minister of Finance and a former Chairman of the Bank of Tokyo. Trustees meet once a year at the time of the IMF/World Bank and IIF Annual Meetings. The Group's mandate includes:

- Review of the evolution of the international financial system as it relates to emerging markets;
- Review of the development of the Principles, including their implementation; and
- Proposals for modification of the Principles, if needed.

The PCG Process in the Second Year of Implementation

The second year of implementation witnessed the continuation of positive dialogue with authorities, strengthened by the growing support of the Principles among authorities and creditors. The PCG continued its work on reviewing countries' circumstances in light of the recommendations set by the Principles as well as a dynamic and constructive dialogue with authorities.

For the most part, PCG members have focused their feedback to authorities specifically to strengthen data transparency and investor relations practices. Discussions on economic policies have continued to be an important element of the dialogue with authorities which, in a number of cases, have responded in a positive way to PCG feedback. This has been reflected in the adoption of policy actions welcomed by the market. A number of countries have strengthened their investor relations practices as well as their work both on the quality of their statistical base and the way in which data is delivered to the market.

The PCG reviewed for the first time a crisis management case using the recommendations set by the Principles, which proved to be a useful set of good practices for voluntary and good faith negotiations in cases where debt restructuring becomes unavoidable. Voluntary and good faith actions in a timely and transparent manner were the preferred form of negotiations between creditors and debtors in the first debt restructuring case discussed by the PCG. The market-based approach recommended by the Principles resulted in a bond exchange accepted by nearly all of the affected creditors.

Moreover, on a technical level, the PCG discussed for the first time the situation of a sovereign beneficiary of development assistance and debt relief potentially seeking first-time access to financing in the international private capital market. The PCG review of this new area is timely given the growing appetite of investors for instruments in low-income countries, reflected in the inflow of foreign capital into local government securities in countries not traditionally exposed to international private capital.

Similar to the first year of implementation, country cases discussed by the PCG can be grouped into three categories with respect to progress in data transparency, investor relations and economic policies.

- Cases with solid policy progress and favorable market sentiment
- Cases with some policy progress but continued market concerns
- Restructuring cases

Cases with Solid Policy Progress and Favorable Market Sentiment

In these cases, the PCG focused mainly on specific recommendations to enhance data transparency and investor relations and policy responses to strengthen investor relations practices. In one case, the PCG noted authorities' sound record of economic management supported by adequate macroeconomic policies, including debt management policies. Members also suggested further strengthening of the macro framework.

The PCG noted sound external positions due to substantial international reserves, lower foreign currency financing requirements, solid export base, and enhanced capabilities to absorb shocks through flexible exchange rates. In several cases, the PCG welcomed and commended authorities for strides made in data provision and investor relations whose practices stand out as among the best in the universe of countries assessed by the IIF. For the most part, the PCG feedback to authorities has translated into further refinement of the way these countries communicate with their investors as well as advancements in data transparency. The high-caliber work on investor relations and data transparency in these countries has had a collateral effect on emerging markets peers with less advanced practices who see this as a model for the crisis prevention aspects recommended by the Principles.

Policy issues in the discussion of one country included PCG members pointing out a number of factors that could potentially limit growth. The dialogue with authorities allowed members to better understand the rationale for policies. Authorities broadly agreed with PCG recommendations regarding the implementation of reforms to enhance productivity.

In one case, the PCG noted the progress authorities have made in establishing a sustainable path for the economy supported by the authorities' commitment to policy orthodoxy. The PCG noted high marks in data transparency and identified room for improvement in its investor relations practices. Members stressed that despite the stellar performance of the economy, policy implementation challenges remain for authorities.

The PCG reviewed the implementation of the crisis prevention aspects of the Principles. For the first time the PCG discussed the situation of a sovereign beneficiary of development assistance and debt relief potentially seeking access to private finance in international capital markets. The PCG review was timely given the growing interest of investors for instruments in low-income countries, reflected in the inflow of foreign capital into local government securities in countries not traditionally exposed to international private capital.

PCG members recommended that a review concerning the need for prudent policy management and market financing be considered in light of the lack of precedent by a debt relief recipient country entering the international bond market. Members noted that a proper balance between market opportunities and risks be considered in determining the timing and design of tapping international private capital markets.

The PCG followed up on the country cases discussed during the first year of implementation. In a number of cases no further intervention with authorities was deemed necessary as policy responses were considered to be appropriate.

Cases with Some Policy Progress but Continued Market Concerns

The PCG discussed a few cases where there was a combination of market concerns regarding investor relations, data transparency and/or economic performance and reform implementation. In some cases, market concerns have centered on a few select elements where improvement was necessary, while in other cases the recommendations were more extensive. In one case, the PCG supported the authorities' efforts to buy back debt instruments as part of an ambitious strategy to reduce the country's external debt stock.

In several countries, the PCG noticed shortcomings in data provision and quality as well as insufficient communication with investors. The PCG communicated with the authorities their concerns about economic policy management and the need for improvement in data transparency and investor relations practices. In addition, limitations in institutional capacity to compile data were pointed out, and the authorities were encouraged to improve their collection and dissemination processes, by adopting an advance release calendar. The PCG conveyed to authorities of one country the limited availability of data and policy information in English; authorities were encouraged to align their English websites with those in domestic languages. In one particular case, PCG feedback was warmly welcomed by the authorities, who in return asked the PCG for assistance on debt management and related data and investor relations issues.

The PCG was pleased in one instance by the progress achieved by authorities to bolster data dissemination and transparency practices. Participants agreed that the country could be better served with further refinements of transparency in

data dissemination as well as a more systematic outreach to investors. PCG members were sympathetic to the response of a small open economy facing a significant surge in capital controls and managed exchange rates in some systemically important countries. However, PCG members raised the issue of the appropriateness of capital controls without fully exhausting alternative measures.

In most cases, the PCG stressed areas in need of improvement with respect to investor relations practices. The PCG identified the need for improvement in communication with investors including active investor lists, conference calls and website mechanisms in order to better understand investors' concerns and feedback. The PCG also underscored the need for publishing amortization schedules as well as domestic debt information.

The PCG also followed up on country cases discussed during the first year of implementation. Further dialogue with authorities was deemed necessary, as market concerns were raised regarding the potential for a unilateral debt restructuring. The PCG drew attention to the guidelines in the Principles for debtor-creditor consultations as well as the country's overall sound financial condition and its relatively strong external position at the time of the discussions which made a restructuring unnecessary. While authorities appeared to respond favorably to PCG feedback and adopted a less confrontational approach to external creditors, there is still uncertainty about their policies going forward.

Restructuring Cases

In the second year of implementation, the PCG closely followed a crisis resolution case in light of the recommendations included in the Principles for dialogue and cooperation among parties involved to avoid restructuring. The debt restructuring process in this case concluded in early 2007 in a debt exchange considered to be market friendly.

During the first year of implementation of the Principles, the PCG maintained an active dialogue with the authorities, briefing them on market-based alternatives for cooperation to avoid default as well as on the willingness of the PCG to cooperate on a resolution favorable to all parties. Authorities were receptive to PCG feedback and demonstrated an inclination towards a market-friendly solution in the design of a homegrown program aimed at restoring macroeconomic stability. In the same connection, affected creditors were briefed on the good faith actions for cooperation and support of debtor reform efforts to avoid a broad debt restructuring. The authorities' commitment to a strong adjustment program as well a transparent and equitable approach was stressed in the communication with creditors briefed by the PCG. Recent political events and the severity of the hurricane season in the country are reminders that macroeconomic stability will be maintained as long as the country maintains a firm adherence to prudent policies.

The Principles have proved to be a useful set of practices for voluntary and good faith negotiations in cases when debt restructuring becomes unavoidable. Voluntary and good faith actions in a timely and transparent manner was the preferred route of negotiations between creditors and debtors in the first debt restructuring case discussed by the PCG. The market-based approach recommended by the Principles resulted in a bond exchange acceptable to nearly all affected creditors.

The debt restructuring case that took place during the second year of implementation was innovative in important areas and a good example for dealing with future cases.

PCG Working Group on Creditor Behavior

In the first year of implementation of the Principles, the PCG process mainly focused on actions of country authorities, but questions arose regarding how to address the proper balance between issuer and creditor focus. This concern was also flagged in the first meeting of the Group of Trustees, when several PCG members as well as a number of Trustees noted the need to consider investor behavior as part of the Principles implementation process, including a review of best practices for creditor committees.

A new Working Group of the PCG was formed in late 2006 in order to define an approach that would allow the PCG to look at creditors' and investors' actions in individual country cases. From an operational standpoint, the second year of implementation of the Principles witnessed the evolution of the PCG process as group members gained experience while working with each other within the PCG framework as well as with issuers and creditors. The growing familiarity between PCG members contributed to a frank and robust dialogue of the PCG Working Group.

The purpose of the PCG Working Group on Creditor Behavior is to design an approach that can be used by the PCG to consider actions and behavior of creditors and investors in light of the Principles. The PCG Working Group has proven to be an important forum to exchange views from a practical point of view on those crisis prevention and resolution elements of the Principles.

Working Group members explored methods to determine the extent to which the crisis prevention aspects of the Principles are currently taken into account in risk management and investment decisions. In addition, its members discussed potential information-sharing mechanisms between issuers and investors. The Group will continue exploring the opportunity for mutual disclosure between issuers and investors.

The strong dialogue of the PCG Working Group has helped to address the crisis containment and crisis resolution aspects of the Principles. In particular, a review was undertaken of best practices for creditor committees developed by the IIF Working Group on Crisis Resolution (WGCR). The best practices for the formation and operation of Creditor Committees presented on page 12 are based on extensive discussions among members of the PCG Working Group and the IIF's WGCR.

The PCG's input has been important in shaping these best practices in order to encourage participation from debtors 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. In fact, the key advantage of Creditor Committees for debtors has been that endorsement of the terms of 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. Additionally, these best practices have been broadly endorsed by the Principles Consultative Group.

Next Steps on Implementation

The Principles implementation process demonstrates a unique collaboration between emerging market issuers and investors to shape a more stable framework for emerging markets finance. The PCG recognizes the novelty of this process and has proceeded gradually in order to develop a process that is mutually agreeable to issuers and investors. Over the past two years, members of the Group have gained experience working with each other within the PCG framework and have suggested improvements to strengthen the quality of the dialogue both within the Group and with authorities. Discussions benefited from cross-country comparisons and infusion of several PCG members' own experiences.

The growing awareness and support for the Principles that has resulted from the implementation process itself is encouraging. The PCG recognizes that more can be done in general to encourage more issuers and investors to embrace the Principles alike. Investor briefings and meetings between key issuers and investors are useful avenues to promote understanding and discussions of the Principles. Continued support by the Paris Club will also be crucial in particular with respect to transparency and cooperative actions in restructuring cases. In addition, as more debtors and creditors adopt the Principles as "modus operandus," it is expected that the Principles will become a commonplace market feature, much the same way as collective action clauses have become over the past few years.

On a technical level, the PCG will consider a more systematic process for country selection, building on its experience. It will broaden the group of countries it reviews beyond those countries that have significant access to international capital markets and include countries that will be seeking market access in the future. At the same time, the Group will need to ensure it remains engaged in the country cases that it has previously discussed. In the context of its country discussions, the PCG will review broader developments in international capital markets, in particular related to areas that could contribute to potential vulnerabilities in the global financial system. The PCG will also review actions by financial institutions or individual creditors/investors in light of the Principles.

The PCG's informal assessments of a country's performance and recommendations are provided by IIF management to authorities. Currently, assessments and discussions with authorities are not publicly released. The PCG will consider over time what aspects of its work could be shared publicly in order to better integrate information on implementation into the marketplace. The IIF reports on investor relations and data transparency practices by key borrowing countries provide a useful benchmark for assessing countries' efforts in these areas. The PCG welcomes regular updates. The PCG will also discuss further if rating agencies should be encouraged to include the Principles in the context of their overall evaluation of countries' creditworthiness.

Some issuers and investors believe that the Principles implementation process should be woven into the fabric of international policy discussions. In addition, in light of the IMF's involvement in PCG calls as an observer, synergies could develop between the PCG's discussions and the Fund's own policy advice. Input could also be given to enhancing implementation of the Fund's data standards, in particular in those areas that are important to investors but where adherence is not currently prescribed. Going forward, discussions could also focus more explicitly on the interface between the Principles and policies of the IMF and the Paris Club, especially in the areas of lending into arrears and comparability of treatment.

Best Practices for Formation and Operation of Creditor Committees

I. Introduction

The Best Practices for the Formation and Operation of Creditor Committees are based on extensive discussions among members of the IIF's Working Group on Crisis Resolution. Additionally, these best practices have been broadly endorsed by the Principles Consultative Group. The PCG consists of senior officials from a broad cross section of emerging market economies and senior bankers and investors involved in emerging markets finance, many of whom have been involved in the formulation of the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets. This Group has been engaged in both encouraging and monitoring the practical application of the Principles in emerging markets through assessments of a variety of country cases. The PCG's input has been important in the shaping of these best practices in order to encourage participation from debtors 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. 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.

The Best Practice Principles for the Formation and Operation of Creditor Committees are based on established practices of the traditional London Clubs 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.

Going forward, support from other key bond investors should also be sought. The Best Practice Principles should also be explained to the IMF and G7 officials in order to facilitate supportive official sector policies, in particular as the IMF reviews its lending into arrears policy. It is important to stress that negotiations in good faith should remain the essence of debt restructuring. 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 restructuring. Such negotiations are also the operational consequences of the restoration of Collective Action Clauses (CACs) which have been welcomed by the G7 and the IMF.

II. The Role of Good Faith Negotiations and Creditor Committees in the Principles for Emerging Markets

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 the operation of Creditor Committees.

However, it is very difficult to come to a precise definition of "good faith" and 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 aim that the final result of the restructuring process should be obtained through cooperative interaction between the debtor and its creditors. (See above section on Good Faith.) 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 balance of payments 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 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."

Recent experience has been mixed, with authorities taking different approaches that were not in all cases seen by creditors as fully consistent with the Principles. All of the cases have been complex, involving a diverse set of market participants, instruments and currencies. In many occasions, creditors have organized themselves into Creditor Committees at an early stage. In some cases, debtors have negotiated in good faith with Creditor Committees to reach restructuring agreements. In others, ad hoc Committees have been formed; debtors have preferred to consult with these Committees as well as with other creditors on a bilateral basis toward the formulation of an exchange offer. In some cases, the approach by sovereigns

has been seen by creditors as coercive. In such instances, the spontaneous formation of Creditor Committees has been frequently resisted by the debtor country with the argument that the situation does not call for a Committee or that the Committee is not representative.

As the Principles will be reviewed from time to time and possibly updated, the circumstances under which Creditor Committees are the best avenue for a restructuring may be reviewed. For example, in one recent case, the restructuring with the private sector was preceded by a restructuring with the Paris Club with the usual request for comparability of treatment. The Principles do not "require" negotiations with a Committee in non-default cases but the question has been raised whether a Committee approach should be preferred in circumstances in which a restructuring is mandated by the Paris Club. This seems to be a logical consequence of the comparability of treatment principle.

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 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."

In addition, in October 2004 the International Primary Market Association (IPMA) released standard collective action clauses for fiscal agency agreements under English law that contain provisions for the appointment of a single Creditor Committee. (IPMA clauses for the Formation of a Noteholders' Committee are attached in Annex A.)

III. Best Practice Principles for Creditor Committees

1. <u>Key Concerns regarding Creditor Committees</u>

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. On the other hand, some members of the creditor community have been reluctant to join Creditor Committees if they saw it as a constraint on their range of options.

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, 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 "represented" other creditors and investors but 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 would 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 in 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.

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.

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), an external representative could be appointed by either an individual fund or a group of fund creditors and investors, if considered necessary. 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 only would provide 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 hold or represent a substantial amount of claims and 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.

D. Speed of Process

1. 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.

2. Creditors and investors should consider approaches to internal coordination that expedite rather than delay the process.

3. 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.

4. 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.

5. 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 is considered confidential.

3. Under the code, parties have to refrain from disclosing confidential information to any one 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 must 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. Both debtor and creditors should avoid commenting on the negotiations.

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. Creditor 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 system should be leveraged as a communication tool in cases where a substantial amount of debt is held at the retail level.

Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets

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 behavior 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 fulfill its payment obligations, the Principles outline a 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.

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