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

REPORT ON IMPLEMENTATION
BY THE
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Overview

The year-long financial market turbulence, triggered by the US subprime mortgage crisis has erupted into a full-blown crisis prompting extraordinary actions by the US and other governments to stabilize financial markets. The market turmoil continues to create stresses in money and capital markets, keeping credit spreads wide and borrowing costs high as well as curtailing the growth of credit in the US and Europe. In addition, the earlier spike in oil and food prices despite their recent correction—has generated such a strong head wind that growth has slowed across the world.

Emerging market countries had performed relatively well until recently, thanks to structural improvements achieved in previous years as well as further progress towards achieving macroeconomic stability. Since mid-year, slowing global growth and more recently the financial turmoil have cast a shadow over emerging market countries. Indeed, many emerging market countries face daunting challenges in the period ahead. Inflation is likely to remain elevated, in some cases, having fed through to strong wage growth. Several countries have posted very large current account deficits. And yet, the policy responses have been mixed—for monetary policy, many countries still maintain substantial negative real policy rates. Furthermore, domestic credit expansion continues apace. As such the appropriate conditions are not being fully created to reduce the economic imbalances—instead those imbalances may be allowed to accumulate and could become more destabilizing in the future without further policy changes.

The continued heightened uncertainty in the global economy and financial markets underscores the contribution of the Principles in building a stronger international financial system by providing a solid framework for crisis prevention in emerging markets. The adaptability and flexibility of the Principles—involving the core pillars of transparency, dialogue, good faith and fair treatment—reinforce their relevance to authorities as well as market participants in dealing with the increasingly challenging outlook for emerging markets. In particular, there has been growing momentum in support of further extending and improving the effectiveness of dialogue among and between market participants and authorities towards promoting stable capital flows to emerging markets. Such dialogue could help the authorities in making informed policy decisions.

The Principles Consultative Group (PCG) has continued in making progress in building a robust framework for debtor-creditor relations, centered on the importance of enhanced transparency, dialogue and bolstering investor confidence through investor relations programs. The PCG provides a regular forum for officials and investors to discuss recent economic and financial developments that have a bearing on emerging markets and concerns about economic performance and policies in selected countries. This process has been found useful by participants, as reflected in their active and growing involvement. Progress has also been demonstrated by the growing number of sovereign investor relations programs. Several emerging market countries have improved their data dissemination practices and enhanced transparency. In addition, it is now more broadly recognized that better working relations gained during good times between issuers and their creditors have helped the dialogue between the parties in the current challenging environment. Meaningful dialogue will be very important to help emerging markets avoid possible policy missteps which can be very costly in the current uncertain environment.

A key strength of the Principles is the ease with which they can be adapted to changes and innovations in the market place, for example, in providing a framework for debt relief in low-income countries and recommendations to new sovereign issuers.

The Principles have continued to offer guidance to countries seeking access to capital markets following the completion of a debt restructuring. The Principles implementation process has supported traditional crisis prevention and resolution cases and more recently it has provided guidance to low-income cases, such as Highly Indebted Poor Countries (HIPC). The benefits of a cooperative, transparent and market-based approach of good faith negotiations in these cases contributed to the restoration of external market access in countries supported by debt-relief programs. These operations exemplify the strength of the Principles as a useful set of voluntary market-based guidelines contributing to the achievement of a satisfactory outcome.

International investors have recently extended their interest beyond traditional emerging markets. This has allowed several non-traditional emerging and developing countries to access international markets. The Principles again demonstrated their flexibility as they can be applied, on a case-by-case basis, to the emergence of new sovereign borrowers. These sovereign issuers have found applying the crisis prevention elements encouraged by the Principles helpful in attracting investors. In addition, discussions and recommendations from PCG members can be useful to these new borrowers in managing their external debt.

Growing support for the Principles was evidenced at the International Capital Markets and Emerging Markets Roundtable which took place in April 2008 in Washington, DC. Senior officials from several emerging market countries, G7 countries, senior IMF officials, including IMF Managing Director Mr. Dominique Strauss-Kahn, as well as leaders from the private creditor and investor community participated in the roundtable. The private sector audience included a diverse group of market participants from investment banks, hedge funds, pension funds, and other institutional investors. In the discussion, participants emphasized the importance of sound macroeconomic policies, investor relations and data transparency, in maintaining stable capital flows to emerging markets.

The PCG has welcomed the continued support by all parties involved in international finance—borrowers, financial intermediaries and investors, as well as international organizations, including the IMF, as the public good provided by the voluntary, market-based Principles facilitates the goal of the IMF to promote international monetary cooperation and enhances stability of the international monetary system.

Benefits of Implementing the Principles

The Principles' overriding strength is that they incorporate voluntary, market-based, flexible guidelines for the behaviors and actions of debtors and creditors which have been developed by all concerned parties. 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 stages of crisis containment.

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

- Information sharing and close consultations between debtors and their creditors to provide incentives for sound policy action in order to build market confidence and thus, ensuring stable capital flows to these countries and preserving financial stability.

- Enhanced creditor-debtor communication by encouraging debtors to strengthen investor relations activity based on market best practices and feedback provided by investors. 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.

- 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 have underpinned a sustainable and healthy flow of private capital to emerging market economies, facilitating needed investment for long-term growth.

In addition , cooperative action and enhanced creditor-debtor communication is consistent with the implementation of debt relief programs supported by multilateral organizations and public sector creditors, in particular, the HIghly Indebted Poor Country (HIPC) Initiative and the Multilateral Debt Relief Initiative, as early communication enables a more accurate calculation of a common reduction factor that provides the basis for the amount of debt relief needed to bring the country back to a sustainable debt level.

New sovereign issuers in particular stand to benefit from the proactive implementation of enhanced data transparency and investor relations practices as recommended by the Principles. New issuers can attract investment, through strengthened communication with creditors.

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 23 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 PCG meetings have advanced as its members have worked together to deal with a variety of issues in the various country cases where implementation of the Principles has been reviewed. Members of the PCG enrich the regular discussions with diverse experiences and perspectives. The membership of the group has slightly increased since the launching of the PCG in 2005 to more adequately represent the evolution of global finance in emerging markets. The PCG maintains an appropriate balance between private and public sector members, as well as membership balanced in geographical scope.

The implementation process has several main functions:

- Monitor and evaluate how the Principles are being adhered to by issuers and investors;
- 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;
- Provide guidance in cases where early course correction can promote better conditions for stable capital flows;
- Provide recommendations to authorities with respect to better investor relations practices and enhanced transparency, including the format and frequency data is disseminated to the market;
- 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 better align their policies and actions 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 IIF consults with members of the PCG as well as other market participants and country authorities as to which countries should be included in PCG discussions. It also prepares background material for PCG discussions, 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 (now renamed Strategy and Policy Review Department) and Monetary and Capital Markets Department as well as a representative from the Federal Reserve Bank of New York join the 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. The 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;
- Proposals for modification of the Principles, if needed.

Investor Relations Practices by Emerging Market Countries

On the occasion of the April 14, 2008 Roundtable on International Capital Markets and Emerging Markets, a new survey of investor relations and data transparency in emerging markets "Investor Relations: An Approach to Effective Communications and Enhanced Transparency," was released. The report, covering 38 emerging market countries, highlights the importance of good communications between market participants and public authorities.

The report includes assessments of six Sub-Saharan African countries that have already or are expected to issue debt on the international capital markets: Gabon, Ghana, Kenya, Nigeria, Tanzania and Zambia. Noteworthy progress has been made by Morocco which launched the first formal investor relations program in Africa. The ability of these countries to communicate with investors is important for numerous reasons: Ghana and Gabon have issued sovereign bonds denominated in a foreign currency; Nigeria's active debt management operations to clear oil-related warrants has gained the attention of international investors; Kenya, Tanzania and Zambia are perceived as potential new issuers in international markets. In addition, investors have shown interest in local currency equity and debt markets in these countries.

Using 44 specific criteria for assessing a country's investor relations and transparency practices, the survey found that Brazil attained the highest overall weighted score for best practices, with Korea and Turkey jointly in second place. The report noted that nine of the thirty-eight countries surveyed now have formal Investor Relations (IR) programs. Since the previous report issued in 2006, the Dominican Republic has made the most significant improvement in the IIF Investor Relations and Data Transparency index, with commendable efforts on improving data transparency and dissemination practices.

The report documents that a number of countries are now following best practices in data transparency and investor relations amid a generally improving overall trend; investor relations practices in Indonesia, Morocco and Peru are becoming more sophisticated but can still improve so as to be on parallel with the superior investor relations practices of their peers from Brazil, Mexico, and Turkey. The report also highlights sophisticated IR practices, such as regular conference calls open to investors organized by authorities from Brazil, Korea, and Mexico, as well as efforts by Peru to regularly disseminate information tailored to investors.

A reemergence of market strains in recent months is a reminder that one important lesson from the traumatic experiences of the crisis in emerging markets in the 90s and early 2000s, is that after strong economic policy and commitment to reform, adequate data transparency and effective communication with investors, plays an important role in helping investors better distinguish among countries within the asset class. Today, by and large, investors have access to more data than in the past, which is delivered in a timelier manner. Equally important, governments are communicating their policy intentions to the market more clearly. The highly regarded practices of enhanced transparency and sophisticated investor relations takes the dialogue between authorities and investors to a further step, as they reinforce borrowers' understanding and communication with their investor base, and allow investors to discuss their concerns, and help shape market-informed policies.

The PCG Process in the Third Year of Implementation

The Principles implementation process has been characterized by a positive dialogue with the authorities and creditors, amidst growing support for the Principles from governments and private financial institutions. The PCG continued its work on reviewing countries' circumstances in light of the recommendations set by the Principles as well as building a dynamic and constructive dialogue with the authorities. These reviews took place against the backdrop of an increasingly challenging outlook for emerging markets, and the emergence of non-traditional issuers in capital markets. The PCG offered guidance to parties involved in a number of crisis resolution and debt relief cases.

The PCG has focused its feedback to the authorities specifically on the areas of strengthening data transparency and investor relations practices. The PCG has also provided guidance in the context of the crisis prevention elements of the Principles. Discussions on economic policies have continued to be an important element of the dialogue with the authorities which, in a number of cases, have responded positively to PCG feedback. Some countries have made considerable progress in strengthening their communication with market participants by implementing formal investor relations programs, while continuing to improve the quality of their statistical base and the format and frequency in which data is delivered to the market .[1]

In recent years, there has been a steady trend towards improving creditworthiness among major emerging economies supported by stronger fundamentals that have improved investor confidence. These improvements include active debt management, more flexible exchange rates and stability oriented macroeconomic policy supported by a growing number of independent central banks. Nevertheless, many countries continue to face a range of challenges derived from a slowdown in global growth and rising inflation pressures.

Implementation of the crisis prevention elements of the Principles has supported emerging market creditworthiness as they provide voluntary guideposts for enhanced transparency and active communication between sovereign borrowers and the private sector. These actions are in line with the recommendations for sound practices in public debt management developed by the IMF and the World Bank. Past experience in financial crises in emerging markets highlight the need for proactive crisis prevention measures by emerging markets, including enhanced transparency and proactive debt management strategies complemented by market-based investor relations programs to help reduce financial vulnerabilities. Implementation of the Principles, along with prudent risk management and stability policies in emerging markets, offer the best course to minimize the risk of financial crises that have often cost emerging economies and their investors dearly in the past.

The PCG reviewed 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 some restructuring cases 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 the situation of a sovereign beneficiary of development assistance and debt relief potentially seeking first-time access to financing in the international capital market. The PCG review of this new area is timely given the growing appetite of investors for investments in low-income countries.

Country cases discussed by the PCG can be grouped into four categories with respect to progress in data transparency, investor relations and economic policies:

- Cases with policy progress and benign market sentiment
- Cases with some policy progress but continued market concerns
- Restructuring cases
- Debt relief cases (for low-income countries)

[1]An update of investor relations practices by 38 sovereign issuers was published in April 2008. The report entitled *Investor Relations: An Approach to Effective Communication and Enhanced Transparency* is available for download on the IIF website.

Selected Countries Discussed by the PCG in the Third Year of Implementation of the Principles

- Congo-Brazzaville
- Ghana
- Nicaragua
- Romania
- South Africa
- Turkey

Cases with policy progress and benign market sentiment

The PCG focused on reviewing the issues faced by the emerging market authorities in the context of a global slowdown, and concerns of potential spillovers from continued financial stresses in mature economies. Generally, private sector participants underscored the resilience observed in many emerging markets. For the most part, countries discussed under this category demonstrated a strong adherence to prudent macroeconomic management. Similarly, these countries are characterized as having an outstanding record in data dissemination and investor relations practices; with PCG members inviting the authorities to refine some current practices.

The PCG noted that sound macroeconomic management helped this group of countries navigate through the recent global financial turmoil and uncertainties surrounding domestic political developments in several countries. In one particular case, the PCG commented on the increasingly difficult challenges to economic management, due to the relentless rise in inflation which is being driven by the surge in oil and food prices.

In fact, in more than one case, inflation pressures appeared to be a major concern for the monetary authorities; and in one particular case the PCG welcomed the responsiveness of the authorities to suggestions of further monetary tightening to moderate inflation, despite growing evidence of a slowdown in economic activity.

Countries under this category were exposed to increased financial market volatility, given the more uncertain financial environment. In one particular case, the exchange rate fell sharply against the dollar while spreads on international bonds also widened significantly.

One country under this category tapped international capital markets creating some controversy over whether or not emerging market countries that had previously secured debt relief from official creditors should risk creating unfavorable debt dynamics with new borrowings so soon after a debt write-off. In its discussion, the PCG took note of the generally favorable outlook for the economy, and the view that the issuance would support government's intention to meet the Millennium Development Goals. Helping the country's case is its implementation of crisis prevention measures, including ongoing work to address existing data transparency problems, benefiting from technical assistance provided by multilateral organizations, and enhancing relations with the investor community.

Cases with some policy progress but continued market concerns

The PCG discussed a number of cases where there have been continued market concerns regarding gaps in investor relations and data release practices and/or macroeconomic policies including policy coordination and the lack of progress on structural reforms. In one case, the PCG took note of the intention of the authorities to tap international markets for the first time, and stood ready to provide guidance to authorities on developing investor relations practices that would benefit the country's nascent debt management practices.

Participants emphasized the challenges for these cases in light of the increasingly difficult international economic environment. The PCG applauded the progress in the efforts to promote macroeconomic stability in some of these countries, while in others additional efforts were required. Market concerns in these cases have ranged from weak policy responses to inflation pressures to the impact of heightened risk aversion among international investors. In one case, the PCG noted the waning of political support for reforms amidst growing perceptions of relatively weak economic fundamentals.

For the most part, the PCG observed existing gaps in investor relations practices in many countries, with the exception of one country case considered a top performer among sovereign issuers as it implements sophisticated investor relations practices. PCG members applauded the excellent record in investor relations and data dissemination practices in this case and invited authorities to refine some current practices. The PCG welcomed the receptiveness of the feedback, as in one case, the authorities conveyed to the group their awareness of the importance of policy credibility.

In other cases, investor relations practices converging to market best practices are a work in progress. The PCG observed that the progress achieved by the authorities in bolstering data dissemination practices presented a mixed picture among the group of countries under this category. In two cases, the PCG was pleased by the progress achieved by authorities to improve data dissemination and release practices. Amidst the more difficult international financial conditions for emerging markets, the PCG considered important for these countries to explore the benefits of implementing investor relations practices based on market best practices and address shortcomings in the statistical database, including the format and frequency data that is delivered to the market, in some cases refinement in this area was deemed necessary.

In one particular case PCG members pointed out the benefits of addressing significant deficiencies in the statistical database for authorities. In this connection, the PCG commented on the need to strengthen budgetary planning and fiscal data.

Restructuring Cases

The PCG closely followed a crisis resolution case in light of the recommendations for cooperation, good faith negotiation, and fair treatment included in the Principles. The experience of one country in restructuring its external debt with private creditors met the expectations of cooperation as the process was conducted in good faith. The PCG welcomed the cooperative and market-based approach, adopted by both the authorities and its private creditors in avoiding litigation and confrontation. Negotiations took place in good faith and these were supported by a code of conduct regarding confidentiality of information. The Principles provided a framework for cooperation for both investors and authorities; affected creditors were provided sufficient and timely information through official sources.

Private sector creditors granted their debt relief share following the decision point of the enhanced IMF/World Bank HIPC Initiative for this country. Close cooperation of a creditor committee with the IMF and the Paris Club facilitated reaching terms of the debt exchange offer considered as fair on both sides.

This offer is the result of intensive negotiations with the creditor committee that was clearly representative of affected creditors. Prior to the negotiations, a complete reconciliation of claims, including interest arrears with private creditors, lead to a clear understanding for both sides of the extent of commercial liabilities. Such a process was a key element of the design by multilateral institutions of the country's Poverty Reduction and Growth Facility (PRGF)-supported program and in particular the "common debt reduction factor." The framework of such PRGF-program ensured affected creditors that the authorities were committing to a strong adjustment program.

Debt relief cases (for low income countries)

In the third year of implementation of the Principles, the market-based recommendations for cooperation and good faith also proved to be useful to countries that are the beneficiaries of development assistance and debt relief. One particular case was complicated given the long standing accumulation of arrears with private external creditors, International Financial Institutions and other official creditors, when the government failed to make payments throughout the years of a severe civil war. The international community, including the PCG, supported authorities' ongoing debt relief efforts.

The authorities and their advisors were receptive to PCG feedback, as meetings with their commercial creditors were ongoing. Participants from the creditor side consider the meetings to have been useful; there is a positive perception regarding the reconciliation process as it is being conducted in a collaborative fashion involving creditors and agents. Both parties have exchanged views and found common ground regarding rather technical issues in the reconciliation process. Private creditors expect that all issues have been taken into account.

Also noteworthy, public sector creditors, including the Paris Club announced an agreement reached among its members with the authorities to restructure the country's external public debt under the enhanced IMF/World Bank HIPC initiative. With the country now fully engaged in the HIPC initiative, its liquidity and solvency ratios are expected to improve significantly. The PCG noted that it will be important to continue with a positive and constructive dialogue with creditors in line with the Principles, as the country stands to benefit from exceptional financing, as well as further reductions in debt obligations from both multilateral and bilateral creditors upon reaching a HIPC completion point.

A second debt relief case was reviewed by the PCG. A buy-back operation supported with financing from external donors took place in cooperation and dialogue with creditors. This operation demonstrated that the Principles are an effective and useful set of market-based guidelines helping to achieve a satisfactory outcome for the affected sovereign as well as its creditors. The actions of both debtor and creditors were based on negotiations in good faith and the operation was characterized by cooperation and dialogue of authorities with a creditor committee. Several meetings involving the authorities, their advisors and the committee prior to the launching of the cash tender offer enhanced the understanding of the much needed contribution of private sector creditors to bring the country's debt to a more sustainable level.

Equally important, application of the Principles enabled the country to clear long standing debt with private sector creditors and end pending legal actions by a number of commercial creditors.

Country Case: South Africa

South Africa was discussed by the PCG in May 2008. PCG member Johan Schoeman, Director of Foreign Debt Management from the South African Treasury provided an overview of the issues faced by authorities. PCG members praised South Africa's strong adherence to prudent macroeconomic management and applauded their outstanding record in data dissemination and investor relations practices. PCG members agreed to invite authorities to refine some current practices.

Participants emphasized the challenges for monetary policy management, faced with inflation well above the authorities' target, and noted the risks to the economic outlook coming from the increased volatility in global markets and growing investor risk aversion.

In late July, IIF management sent a letter on behalf of the PCG to Trevor Manuel, Minister of Finance, South Africa and member of the Group of Trustees of the Principles, commending South Africa's strong adherence to prudent macroeconomic management and highlighting key points of the May PCG discussion.

The Experience of Congo-Brazzaville in Restructuring its External Debt

Progress in macroeconomic stabilization supported by debt relief from multilateral donors in the 90s suffered a serious setback after the resumption of harsh civil conflict, leading to accumulation of arrears. Emerging from a severe conflict situation, Congo-Brazzaville has made significant progress in implementing macroeconomic, financial, and structural reforms. Despite efforts in securing macroeconomic stability the country is still being afflicted by the consequences of civil unrest.

At the end of 2006, total external public debt of Congo-Brazzaville is estimated to have been $6.5 billion, approximately 75 percent of GDP. The share of debt owed to commercial creditors represents approximately 50 percent of total external public debt. In March 2006, under the enhanced HIPC initiative the country qualified for debt relief, providing the basis for negotiations with commercial creditors. Almost simultaneously, the Paris Club agreed in principle to provide financing relief on Cologne Terms to those maturities falling due from March 09, 2006 up to September 30, 2007, provided the country met the fiscal and monetary targets set out for it under a new three-year PRGF-supported program with the IMF. The country benefited from the cancellation of nearly $1.7 billion and rescheduling of about $1.3 billion in the context of the Paris Club agreement. The March 2006 agreement with the Paris Club followed a debt relief package agreed by its members on Naples terms in 2004.

Following the decision point under the enhanced IMF/World Bank HIPC Initiative in March 2006, the authorities started discussions with a creditor committee to negotiate the settlement of arrears on terms comparable to those under an enhanced IMF/World Bank HIPC Initiative. The consultation process moved forward and a code of conduct signed between participating creditors and the authorities established the details for the disclosure of confidential information.

On June 29, 2007, discussions led to an agreement in principle on the restructuring of the Congolese external debt, known as London Club debt, which amounted to $2.3 billion as of June 30, 2006, including $1.9 billion of interest arrears accumulated since 1984. Close cooperation of the creditor committee with the IMF and the Paris Club facilitated reaching terms of the debt exchange offer considered as fair on both sides. The authorities expect to disburse the first payment on the Eurobonds in an amount equal to 5 percent of principal on the closing date of the issuance.

This offer is the result of intensive negotiations with a creditor committee that was clearly representative of affected creditors. Prior to the negotiations, a complete reconciliation of claims, including interest arrears with private creditors, lead to a clear understanding for both sides of the extent of commercial liabilities. Such a process was a key element of the design by multilateral institutions of the country's PRGF-supported program and in particular the "common debt reduction factor."

Nicaragua's External Debt Buy Back

In October 2007, the Government of Nicaragua invited holders of $1.4 billion in external commercial debt, to tender their existing claims for cash on the basis of a price of 4 1/2 percent of principal plus associated interest and penalties. The overall eligible debt was due to 13 financial institutions (who did not participate in the 1995 buy-back operation), more than 100 commercial suppliers, and a number of former state-owned companies.

Tender representing more than $1.3 billion in eligible claims were accepted for redemption by Nicaragua in December 2007 with the notable participation of 99 percent of the financial institutions, and the entirety of existing judgment creditors. After the first closing of the operation, Nicaragua's external public debt to GDP ratio dropped to approximately 57 percent, compared to 161 percent as of December 2003, according to government figures.

The Nicaragua debt buy-back operation was implemented with resources from the World Bank's Debt Reduction Facility (DRF) with the financial support from six donor countries. The operation was performed on the basis of the modified DRF principles adopted in 2004. Improvements have been made to the DRF in light of the diversity of investors in HIPC countries. These include recognition of interest, in addition to principal; a move from "lowest possible price" to "best possible comprehensive deal" approach in order to attract holdout creditors, and an increase in the participation rate requirement thereby leading to comprehensive solutions.

Nicaragua's second buy-back operation showed that cooperation and dialogue with creditors can prove effective in achieving a satisfactory outcome for the country as well as its creditors.

Observations from Nicaragua's Debt Restructuring

- The authorities and private creditors, including litigating creditors, adopted a cooperative and market-based approach.

- A creditor committee recognized by the authorities was formed representing 75 percent of total debt, including all judgment creditors.

- There was comparability of treatment following the decision point of the enhanced HIPC Initiative. The common reduction factor for all creditors was set at 73 percent.

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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