FOR AGENDA

EBS/00/42
Supplement 1

CONFIDENTIAL

March 17, 2000

To: Members of the Executive Board

From: The Secretary

Subject: **Report by the Staff on Meeting with Market Participants on Private Sector Involvement**

The attached report by the staff on a meeting with market participants on private sector involvement serves as background information to the paper on involving the private sector in resolving financial crises—experience and principles, which was circulated as EBS/00/42 on March 7, 2000.

Mr. Allen (ext. 38786) and Mr. Fisher (ext. 38755) are available to answer technical or factual questions relating to this paper prior to the Board discussion scheduled for Monday, March 20, 2000.

Att: (1)

Other Distribution:
Department Heads

Report by the Staff on Meeting with Market Participants on Private Sector Involvement

March 17, 2000

1. Management and senior staff met with a small group of private market participants on Tuesday, March 14 to discuss how they saw the current set of issues relating to private sector involvement. Participants were given a short paper consisting of part of the Executive Summary and Box 2 of EBS/00/42 (03/07/00). A list of participants is attached.

2. The main conclusions of the meeting were:

Prevention of crisis

3. Prevention of financial market crisis remained the most crucial element on the work program. In this context, participants stressed the importance of information flows, with both countries and the Fund providing more data and more analysis of countries' situations, including in particular the sustainability of their debt. They called for as rapid a dissemination of Article IV reports as possible and for the publication of letters of intent to be a condition for the use of Fund resources.

4. Close and early contact between a country and its creditors was important both in preventing financial crises and in dealing with them. The participants thought the Fund should use the Article IV consultation process to encourage strongly countries to follow the examples of Mexico and Argentina in holding regular briefings of creditors, although they recognized that less labor intensive techniques might be appropriate for smaller market borrowers.

5. There was little enthusiasm for establishing standing creditor committees. When there was a need for such committees in the course of negotiations, they were better created on an *ad hoc* basis, as the relevant creditors would vary from case to case. Participants noted that if a country cultivated its relations with its creditors, creditor committees would form through a self-selection process at times of stress. They also noted that many large financial institutions had such varied forms of involvement with the country that the true corporate view of a given institution only emerged when difficult decisions had to be taken.

6. There was support for incorporating collective action clauses in bond contracts, but a recognition that the large stock of bonds without such clauses would continue to exist for a long time. Sharing clauses in bond contracts, they felt, were impossible to implement, but one participant pointed out that trustee provisions could be regarded as having a similar effect. There was no enthusiasm for "clawback" or value recovery instruments: the main difficulty was that the market found them notoriously difficult to price.

7. There was a lively discussion on the usefulness of private contingent credit lines, but without convergence of views. Some felt that the lines needed to be more attractively priced from the lenders' point of view, while others felt that hedging practices might reduce their usefulness to the country in a crisis.

8. Participants felt that relatively few emerging market countries managed their debt in such a way as to improve its terms and reduce overall vulnerability. Such management could well include restructurings and debt exchanges at times when market sentiment was favorable. They felt the Fund should encourage the more experienced emerging markets to share their expertise in this regard with other countries, since many national debt managers felt it was hard to get disinterested advice directly from private financial institutions.

Proposed framework for private sector involvement

9. Participants expressed a strong preference for continuing a case-by-case approach, since the cases so far have been so diverse in terms of debt structure and economic situation as to make deriving general principles problematic.

10. Several participants took exception to proposition 1, and the qualification to proposition 2. They argued that the official sector had a duty to provide adequate financing to countries with good prospects of returning to the market. They argued in particular that the financing roles of the official and private sectors were quite distinct, with much of the official sector's exposure and willingness to act dependent on geopolitical criteria, rather than strictly economic ones. In addition, they considered the burdens proposed to be unbalanced since, unlike their resources, official financing was risk-free.

11. Participants expressed the view that private sector involvement should not be the residual after the financing gap and official financing had been determined, but these magnitudes should be determined iteratively through a collaborative process. They also felt that the Fund was too quick to trigger concerted private sector involvement.

12. Reviewing the propositions made by the staff, participants observed that it was extremely hard ex ante to determine into which category a country fell, either in terms of the financing needs or in terms of its prospects for market access.

13. Participants observed that the expression "concerted private sector involvement" was a euphemism: in practice it meant leaning on banks to maintain exposure, a debt moratorium, a cessation of debt service, a debt exchange, or a debt restructuring. They felt the analysis would be clearer if this limited menu was spelled out.

The debt workout process

14. Participants repeatedly stressed the need for countries (and the Fund) to approach a country's creditors at an early stage in the country's difficulties, rather than late in the day.

15. While the process of negotiations could be complex, with different creditor groups driven by different regulatory and fiduciary considerations, the evidence showed that debt restructuring and debt exchanges were easier to arrange than some had feared. Once the workout process was launched, large changes in the composition of the creditor group could be expected, with bonds moving from certain institutions to others more interested in recovering the value of distressed debt. It was important to the country's future viability that voluntary solutions be found that accommodate the particular interests of different creditor groups.

16. While participants did not foresee extensive use of legal remedies as a general rule, they indicated that they would consider using them when a debtor was not cooperating with its creditors. They were also strongly opposed to any moves to limit their right to use legal remedies, in particular the use of Article VIII, Section 2(b) in this context.

17. Most participants understood the Fund's "lending into arrears" policy to balance the interests of debtors and creditors appropriately. Some, however, were very concerned that in practice the Fund might decide to lend even where the debtor was not dealing with its creditors in good faith.

Consultative Meeting on Private Sector Involvement
March 14, 2000

Mr. Josef Ackerman[1]
Member of the Board of Managing Directors
Deutsche Bank, AG

Mohamed El-Erian
Managing Director
Pacific Investment Management Company

Dr. Jacob Frenkel
Chairman
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Mr. Robert Gray
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Mr. André Icard
Deputy General Manager
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Mr. William Rhodes
Vice-Chairman
Citigroup, N.A.

Mr. Ernest Stern
Managing Director
J.P. Morgan

Mr. Mark Walker
Partner
Cleary, Gottlieb, Steen & Hamilton

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[1] Unable to attend at the last moment.