

**COMMUNIQUE OF THE MINISTERS AND GOVERNORS  
OF THE GROUP OF TEN**

Washington, D.C., April 22, 1996

1. The Ministers and Central Bank Governors of the countries participating in the General Arrangements to Borrow (GAB) met in Washington on April 22, 1996, under the chairmanship of Mr. Gerrit Zalm, Minister of Finance of the Netherlands.
2. The Ministers and Governors took note of ongoing discussions between *the G-10 countries and other countries with the capacity to support the international monetary system aimed at developing new financing arrangements which would double the supplementary resources currently available to the International Monetary Fund (IMF) under the GAB for coping with international financial emergencies.* They welcomed the progress that has been made in reaching agreement on broad principles guiding the design of the new arrangements and stressed the desirability of bringing the discussions to a successful conclusion as soon as possible.
3. The Ministers and Governors commended the report of the Working Party on the Resolution of Sovereign Liquidity Crises, prepared under the auspices of their Deputies, and agreed that the report should be released to the public. They affirmed that, given the need to contain moral hazard and the desirability of equitable burden-sharing, neither debtor countries nor their private creditors should expect to be insulated from any adverse financial consequences of their decisions by the provision of large-scale official financing in the event of a crisis. Moreover, there should be no presumption that any type of debt to the private sector will be exempt from payments suspensions or restructurings in any future sovereign liquidity crisis.
4. The Ministers and Governors recognized that the current flexible, case-by-case practices and procedures, as they have evolved over the years, are an appropriate starting point for considering how to respond to sovereign liquidity crises, and that *improvements should continue to be evolutionary.* In this connection, they endorsed the conclusions of the report, which also appear in the attached Executive Summary. They underlined their concurrence with the recommendations concerning actions that could be taken to improve existing practices and procedures and stressed that it was desirable for the appropriate private sector groups to take the lead in developing any new contractual arrangements. They affirmed that the official community's primary role in the resolution of sovereign liquidity crises should remain centered on the promotion of strong and effective adjustment by debtor countries in the context of IMF-supported programs.

**5. The Ministers and Governors expressed support for the work being done by the Basle Committee on Banking Supervision, the International Organization of Securities Commissions and other bodies to foster the soundness of financial institutions and markets. In this context, they welcomed the efforts to increase cooperation among authorities responsible for supervision and the stability of financial markets, and concluded that they provided a helpful basis for further work in this area. They also emphasized the importance of adherence to credible and consistent economic policies and endorsed actions to reinforce market discipline through the establishment of data dissemination standards by the IMF and the strengthening of surveillance procedures.**

**Attachment**

# THE RESOLUTION OF SOVEREIGN LIQUIDITY CRISES

## Executive Summary

1. Following an invitation to the Ministers and Governors of the Group of Ten by the Heads of State and Government of the Group of Seven in Halifax in June 1995, the Deputies of the Group of Ten established a working party to consider the complex set of issues arising with respect to the *orderly resolution of sovereign liquidity crises*. While taking a comprehensive view of the problem, the Working Party focused its attention on those forms of debt to private creditors, such as internationally traded securities, that have increased in importance in the new financial environment but that in the past have usually been shielded from payments suspensions or restructurings. In carrying out its work, the Working Party recognised that the highest priority needs to be given to measures that will help prevent crises from occurring and endorsed efforts underway in other forums to improve market discipline and strengthen the surveillance of sovereign borrowers' economic performance. It attached particular importance to the need for sovereign borrowers to make timely changes in their economic policies if conditions change in ways that may lead to reductions in capital inflows.

2. After careful review of analyses of the full range of questions involved, and taking into consideration surveys of the views of market participants and of legal practices relating to collective representation of debt holders that were conducted by its members for this purpose, the Working Party reached the following broad conclusions.

- First, it is essential to maintain the basic principles that the terms and conditions of all debt contracts are to be met in full and that market discipline must be preserved. However, in exceptional cases, a temporary suspension of debt payments by the debtor may be unavoidable as part of the process of crisis resolution and as a way of gaining time to put in place a credible adjustment programme.
- Second, neither debtor countries nor their creditors should expect to be insulated from adverse financial consequences by the provision of large-scale official financing in the event of a crisis. Markets are equipped, or should be equipped, to assess the risks involved in lending to sovereign borrowers and to set the prices and other terms of the instruments accordingly. There should be no presumption that any type of debt will be exempt from payments suspensions or restructurings in the event of a future sovereign liquidity crisis.
- Third, current flexible, case-by-case practices and procedures, as they have evolved over the years, are an appropriate starting point for approaches to sovereign liquidity crises. They emphasise the importance of adjustment efforts of the debtor country and place principal responsibility for workouts on the debtors and creditors, with the debtor country having

primary responsibility for setting the process on a co-operative footing. Improvements in practices and procedures should continue to be evolutionary.

- Fourth, international bankruptcy procedures and other formal arrangements do not appear to provide, in current circumstances or in the foreseeable future, a feasible or appropriate way of dealing with sovereign liquidity crises. However, further study by private sector entities may be warranted.
- Fifth, further consideration should be given in appropriate forums to ways in which financial systems in emerging market economies could be strengthened in order to reduce the risks they might pose in the event of a sovereign liquidity crisis.
- Sixth, a market-led process to develop for inclusion in sovereign debt instruments contractual provisions that facilitate consultation and cooperation between debtors and their private creditors, as well as within the creditor community, in the event of crisis would be desirable. Market initiatives would deserve official support as appropriate.
- And seventh, note was taken of current policies of the IMF that provide, under exceptional circumstances, for lending in support of effective adjustment programmes prior to full and final resolution of a sovereign borrower's arrears to private creditors. It would be advisable for the IMF Executive Board to review existing policy in this area and to consider whether the scope of its application should be extended to other forms of debt not now covered, while remaining mindful of the need for prudence and the maintenance of strict conditionality.

3. The thinking of the Working Party was influenced by three basic changes in the financial environment bearing on the character of potential future sovereign liquidity crises. First, the broader and stronger linkages among domestic and international financial markets mean that crises can erupt much more quickly in today's markets and can be far larger in scope than in the past. Second, flows of capital to emerging market economies in the form of purchases of securities have increased greatly in size over the years and have substituted for other types of private capital. Third, when a crisis occurs new finance is unlikely to be forthcoming from those who undertook the original lending. These changes mean that financing available from official sources is less likely to be sufficient to enable a sovereign debtor experiencing a crisis to meet fully its external financing obligations. In any event, the Working Party stressed that provision of official funds to limit private losses raises serious moral hazard risks and could interfere with market discipline.

4. In considering means to deal with future sovereign liquidity crises, the Working Party was of the view that no single pre-set procedure can be suitable in all cases. However, it identified a broad set of desirable principles and features that provide a framework for the development of procedures for handling sovereign liquidity crises in a flexible, case-by-case approach in light of the conditions prevailing at the time, the nature and the intensity of the crises, and the circumstances of the debtor. Any such procedure should have the following features.

- It should foster sound economic policies by all debtors.

- It should minimise moral hazard for both creditors and debtors.
- It should rely on market forces and not interfere with the efficient operation of secondary markets in relevant debt instruments.
- It should limit contagion from one debtor's problems to other countries.
- It should support credible and sustainable actions and, to this end, not impose excessive social, political, or economic costs on the debtor.
- It should seek to ensure that burdens associated with the provision of exceptional financing are allocated fairly within and across different classes of creditors.
- It should strengthen the ability of governments to resist pressures to assume responsibility for the external liabilities of their private sectors.
- It should be suitable for quick and flexible use in a variety of different cases.
- It should be cooperative and non-confrontational, and promote the adoption by debtors and creditors of arrangements to facilitate resolution of liquidity crises should they occur.
- It should build on existing contractual or other arrangements that facilitate the resolution of crises.
- It should make use of existing practices and institutions.

5. The Working Party concluded that the establishment of a formal international bankruptcy procedure would not be feasible or appropriate under present circumstances or in the foreseeable future. Sovereign debtors have not in the past had a strong need for legal protection against their creditors, nor could they be obligated to submit to the jurisdiction of a bankruptcy forum. However, the Working Party noted that interested private parties might wish to continue to study the merits of bankruptcy or other formal procedures. At the same time, the Working Party concluded that it is not possible or desirable to preclude official involvement altogether in the event of a serious crisis. The official community's interest in containing systemic risk and its role as a lender to sovereign borrowers mean that it has a stake, and therefore a role to play, in fostering cooperative efforts by debtors and creditors to contend with unexpected payments problems.

6. In considering specific ways to facilitate resolution of sovereign liquidity crises, the Working Party took the view that current practices are an appropriate starting point. Current practices were developed over the course of the past few decades to contend with real world problems in a pragmatic and flexible manner. They are voluntary and make use of market information and market forces. The practices recognise the distinct perspectives of the three main actors involved in a crisis - the official community, private creditors, and the sovereign debtor - as well as their common interest in the orderly resolution of the crisis. They involve national authorities and multilateral institutions but place principal responsibility on the individual debtor and its creditors. The practices are based on the implementation of an IMF-supported sustainable adjustment programme as a major precondition for the cooperative resolution of a crisis.

7. The Working Party recognised that structural weaknesses in the banking systems of debtor countries could seriously aggravate liquidity crises and might pose difficulties for financial systems in lender countries. The Working Party concluded that further work should be undertaken in appropriate international forums to promote the strengthening of financial systems in emerging market economies and thus help to reduce such risks.

8. The Working Party took the view that certain contractual or statutory provisions governing debt contracts can facilitate the resolution of a crisis by fostering dialogue and consultation between the sovereign debtor and its creditors and among creditors, and by reducing the incentive for, or ability of, a small number of dissident creditors to disrupt, delay or prevent arrangements to support a credible adjustment programme that is acceptable to the vast majority of concerned parties. Among such provisions are those that (a) provide for the collective representation of debt holders in the event of crisis, (b) allow for qualified majority voting to alter the terms and conditions of debt contracts, and (c) require the sharing among creditors of assets received from the debtor. Such clauses have been employed in a limited set of debt contracts. The Working Party emphasised that evolution of contractual arrangements between sovereign borrowers and their creditors needs to be a market-led process if it is to be successful. Such efforts should receive official support as appropriate.

9. The Working Party strongly endorsed the fundamental principle that the terms and conditions of all debt contracts are to be met in full and on time. At the same time, it recognised that in certain exceptional cases the suspension of debt payments may be a necessary part of the crisis resolution process. Such payment suspensions should be non-confrontational and implemented in a way that does not hamper the operation of secondary markets. The Working Party did not consider that it would be feasible to operate any formal mechanism for signalling the official community's approval of a suspension of payments by the debtor. Although the Working Party rejected any formal international approval of a suspension of debt payments, it concluded that it would be advisable for the IMF Executive Board to consider extending the scope of its current policy of lending, in exceptional circumstances, to a country that faces the prospect of continuing to accumulate arrears on some of its contractual debt-service obligations to private sector creditors, in cases where the country is undertaking a strong adjustment programme and making reasonable efforts to negotiate with its creditors. Such lending can both signal confidence in the debtor country's policies and longer-term prospects and indicate to unpaid creditors that their interests would best be served by quickly reaching an agreement with the debtor.

10. The Working Party reached the overall conclusion that there is no need to change current procedures for official bilateral credits and long-term bank claims. However, there is a need for the principles and procedures for handling sovereign liquidity crises to take into account the new

importance of debt in the form of securities and the growing likelihood that some such debt may have to be subject to renegotiation in the future. While the official community may be able to facilitate dialogue and assist in data collection, market participants should make the decisions regarding any innovations in contractual provisions. The official community's primary role in the resolution of sovereign liquidity crises should remain centred on the promotion of strong and effective adjustment by debtor countries in the context of IMF-supported programmes, which would need to take into account any recourse to temporary suspensions of payments.