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MOVING FROM WORDS TO ACTION

Notes on the International Conference on Financing for Development

Monterrey, Mexico
March 18 – 22, 2002

by
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Background on the Monterrey Meetings

Moving from words to action was the theme of the private sector proposals[1] presented at the International Conference on Financing for Development convened by The United Nations, in Monterrey, Mexico ("the Conference"), from March 18 to 22, 2002. These meetings in Monterrey differed from the usual UN conference in a number of ways. First, while convened by the UN, it was undertaken in collaboration with the IMF, the World Bank and the WTO. Second, for the first time the global business community participated. A steering committee of business interlocutors was set up[2] in advance of the Conference. This committee organized a Business Forum at the Conference, selecting senior private sector executives to engage senior government officials on policy oriented issues in a roundtable format, and to present concrete proposals to achieve specific development goals. Third, as a result of the above, representation was at the highest level, with roughly 130 Ministers (principally Finance, State, and Trade) attending the Conference, along with more than 50 Heads of State. U.S. government representation included President George W. Bush and Treasury Secretary Paul O'Neill.

SIA was a strategic partner in this effort ("a critical global collaboration" in the words of the UN), participating in the planning and presentation of the Roundtables and the private sector proposals. Frank Fernandez, SIA's Chief Economist and Director of Research attended and moderated a panel discussion hosted by the SIA. Below are his comments at the Ministerial Roundtable, followed by summary of one of the formal business proposals presented at the Conference, and some comments from that SIA-sponsored panel on sovereign debt workouts.

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1 "Strengthening Financing For Development: Proposals From The Private Sector", *Comments on the Monterrey Consensus and Proposals for the International Conference on Financing for Development*, March 2002, Compiled by the UN-sanctioned Business Interlocutors to the International Conference on Financing for Development, 83 pp.

2 See for example, "Comments on the Facilitator's Redraft and Specific Proposals for the International Conference on Financing for Development Made by The Following Entities: International Chamber of Commerce; Business Council for the United Nations; Money Matters Institute; Renaissance Strategy; Samuels Associates, and; the World Economic Forum," Preparatory Committee for the International Conference on Financing for Development, United Nations, January 10, 2002.

In the **Ministerial Roundtable** on March 19, 2002 participants were asked to build on the comments of preceding speakers with the intent of building a dialogue and developing ideas. The following are notes prepared by Frank Fernandez for presentation at that roundtable.

Auditing and Accountability

"Thank you for the opportunity to address you today. I believe all the representatives of the private sector applaud the efforts of the multilateral organizations to include the business community in these important discussions. There appears to be wide acceptance that there should be greater private sector participation in the prevention and resolution of financial crises in emerging markets, as well as in the setting and implementation of key international financial codes and standards. However, it appears that many official representatives are not fully aware of the how involved the private sector already is in these, and other, critical development issues. During the 1990's the private sector accounted for roughly 80% of all capital flows to developing countries, compared to 50% in prior decades. With these greater flows and the increased frequency of crisis came increased responsibilities for financial service firms. These firms responded with improved risk management practices and increased involvement in a number of key issues. A recent report, "Rebuilding the International Financial Architecture," points out that:

> *"The first half of the 1990s saw a massive expansion of private financial flows from developed to developing countries, which was widely welcomed as a positive contribution to development. However, the second half of the 1990s revealed that these private flows could be easily reversible, as a succession of financial crises in emerging markets seriously set back important progress in economic growth and poverty reduction….Financial fragility in many emerging market economies has been exacerbated in the past by poor corporate governance in (domestic) financial institutions and corporations (both state-owned and private), inadequate financial regulation and supervision, weak institutions and insolvent fiscal systems. Much progress has been made, … however, stronger prudential standards, sound macroeconomic fundamentals, enhanced risk management and improved transparency, although necessary, are not sufficient to provide an assurance of market stability. International action on a coordinated basis is clearly also required."*[3]

The SIA has long advocated the need for increased transparency and for improvements in key codes and standards.[4] A summary of those standards identified by the Financial Stability Forum as crucial for sound financial systems are included as **ATTACHMENT ONE**.[5] A large number of these standards already exist along with defined objectives, monitoring and implementation. While substantial progress has already been achieved, accelerating these efforts would improve prospects of achieving other development goals. Other standards to improve the timeliness, relevancy and availability of information and analysis to the market to improve investors' ability to assess risks and rewards have been proposed.[6] While the private sector is actively supportive of these efforts, the official sector must realize that these are essentially "public goods" and their provision is both difficult and costly. The public sector needs to apply additional resources, both for technical and financial assistance to support the implementation of key codes and standards, as well as to fund third-party evaluations of these efforts.

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3 Emerging Markets Eminent Persons Group Report, "Rebuilding The International Financial Architecture", Seoul Korea, Oct. 2001, Institute for Global Economics, igenet@igenet.com

4 "Promoting Fair and Transparent Regulation: Discussion Paper" (contact: David G. Strongin, 212-618-0513; dstrongin@sia.com) http://www.sia.com/international/pdf/fair_transparent_regulation.pdf

5 The full text of the Financial Stability Forum's "Key Standards for Sound Financial Systems" can be found at http://www.fsfourm.org/ Standards/Repiscsfs.html

6 "Laying the Foundation for a Global Financial Passport,"a discussion paper by Judith Chase in SIA's *Research Reports*, Vol. I, No. 3 (April 18, 2000) http://www.sia.com/reference_materials/pdf/Vol1-3.pdf

How Can We Meet the Millennium Goals?

An earlier speaker noted that the most important role we play here today might be our "impact on the collective consciousness" or in other words, on civic society. By setting the Millennium Goals and by inviting the private sector to present proposals to reach concrete outcomes at this conference, you have raised expectations that action to meet those goals will ensue. It would be far worse to raise expectations and then fail to meet them than never to have raised those expectations at all. It would undermine the legitimacy of all the institutions represented here. Moving from words to action is therefore necessary. While it would appear that these goals are attainable and that we have the resources to meet these goals, we can make much better use of those resources we do have.

As an economist, and still worse, a Wall Street economist, I am perhaps out of my element here. However, what I observed in two decades working in emerging markets is that what is lost through economic mismanagement, graft and corruption, and through financial market instability far exceeds what can be provided in aid. For example, it has been pointed out that a banking crisis in a developing country can be expected to erase 10% to 20% of that country's GDP. And the burden of these losses generally falls on those least able to support it: the poor and lower-middle income, those on fixed incomes (retirees, pensioners and the aged) and on savers and domestic financial institutions. It also appears that these crises are occurring with greater frequency and severity in recent years and that we have been witnessing higher, near record, sustained levels of volatility in financial markets. It should be equally apparent that, given the high rates of domestic savings in many developing countries, if we could support liberalization and maturation of local capital markets and hence the mobilization of these savings, rather than see the overwhelming bulk of them flow into developed financial markets, we would have a greater chance of achieving sustainable development. The proper speed and sequencing of reforms is key to achieving sustainable development, and one of the first steps is to ensure the existence of adequate domestic market depth and prudential regulation of financial services firms. Attaining this is a condition precedent to achieving sustainable progress on most other reforms.

Given our scarce resources, more effective use of aid becomes a second pre-condition. There appears to be a consensus here today that auditing and greater accountability of both donors and recipients of aid is needed, and it has been proposed that additional aid flows could be directed to where they are most effectively employed as an incentive to carry out reforms. Donors should be monitored to ensure that they meet the pledges they have made and that funds reach their intended goals and support responsible projects. Recipients should be audited to ensure that aid flows are not wasted. The SIA has long advocated the need for increased transparency and accountability. However, the credibility of these assessments is critical.

This credibility depends in part on who provides this audit function, how the assessments are distributed and how sound the assessments prove to be. There is also perceived to be a need for a new method of dissemination of the information and analysis that market participants need to assess more effectively the risks of investing in emerging markets. This need arises in part because of an inherent conflict of interest that arises between the official sector's desire to stabilize markets, and the need to maintain the confidentiality of some information supplied to multilateral institutions by their member countries. It is for this reason that I do not believe that adding these assessments to IMF Article IV Consultation documents, as has been suggested by the co-chair, would meet this need. The users of these assessments must be sure that they are not biased, nor suffer from significant omissions. Therefore it has been proposed here that politically motivated institutions should not conduct these audits. Instead, we have proposed in detailed form how independent, third parties, standing at arms length from all governmental bodies, could provide these assessments.

I would go further. Perhaps it is time to accept the idea that governments have the same responsibility of disclosure and accountability of performance to its stakeholders, which is civic society, that corporations in the US are now being required to provide to their shareholders. I would ask, that governments, voluntarily of course, provide quarterly and annual reports for evaluation by expert, independent analysts and that these reports and the subsequent evaluations be freely and easily accessible to all.

Part of what inhibits investor participation in emerging markets and contributes to systemic instability is uncertainty. This uncertainty arises, in part, from investors' inability to adequately assess the risk/reward tradeoff due to a lack of essential (economic, financial, political, social, etc.) information and analysis of developing countries. Recognizing that access to these assessments is a public good is an important first step, for while these assessments should be prepared and distributed by the private sector, they cannot do so without the participation and support of the public sector.

The private sector does have another important role to play here, and not just in the provision of portfolio and direct investment in developing countries. My colleague to my right from Daimler Chrysler drew on the experience of the Mexican earthquake to show what is possible when civic society mobilizes. I was in Mexico City at that time and I was working near the WTC on September 11th and in the days that followed. I saw efforts that were Herculean, and at times, heroic. I cannot answer his question of why it takes a horror to bring out our humanity, why we as a species are at our best when times are worse. But I know that it is true. Nor should we forget what President Carter to my right said earlier: that more people die each day of HIV/AIDS in Africa than died that day at the WTC. But we cannot become inured or calloused to the toll of disease and deprivation simply because that horror is recurring daily.

Among the many lessons of 9/11 are that there is an increased appreciation for crisis prevention, improved risk management practices and the value of contingency and continuity planning. We have also learned both that the private sector has a vital role to play in public policy formation, and that what can be accomplished by active public/private sector cooperation far exceeds the sum of what can be achieved independently. If we can maintain the unprecedented level of private/public sector cooperation that we have witnessed in the US in the last six months and if we can apply a portion of the intensity of effort and resources devoted to the War on Terrorism to a War on Disease and Poverty, we can meet the Millennial Goals. So I urge you to carefully review the private sector proposals presented here this week. If you find the proposals wanting, charge us to do better. If you find us, the representatives of various business interests here today, wanting, replace us and call for additional proposals. These proposals are well designed and seek concrete outcomes that are worthy of your consideration and support in implementation.

Frank A. Fernandez
Senior Vice President, Chief Economist
and Director, Research

THE GLOBAL CLEARINGHOUSE
An Independent Information Initiative Bridging Governments And Investors

The Global Clearinghouse, with initial support from the Norwegian government and the Ford Foundation, is aimed at strengthening information and analytics in the global financial system. As an independent expert information initiative, the focus is on bridging costly gaps between investors and governments in areas critical to effectively mobilizing domestic and international private sector capital:

- Provision of credible timely relevant information and analysis on countries and markets
- Timely, quality assessment of risks and opportunities
- Use of effective risk management services and strategies
- Formulation of effective crisis prevention policies; and
- Development of innovative and effective financing mechanisms.

Four specific related networking functions that harness expertise from across the private and official sectors include:

1. **The establishment of a global information clearinghouse**, bringing together existing free and pay-for information with cost-effective user interfaces. The clearinghouse could help meet the challenge of providing technical assistance, facilitate the implementation of codes and standards and bridge gaps in information and analytics needed for market investment decision-making;
2. **The development of country-investor networks** linking investors with governments on a real-time basis to exchange views and information. These networks could provide "business-enabling environments" by facilitating direct exchanges between governments and investors on impediments to finance and possible remedies and by focusing scarce resources and priorities for reform;
3. **The creation of independent expert groups** providing expertise and recommendations on policy and financing options to policy makers and investors. These groups could provide critical checks and balances against short-term pressures and vested interests, enhancing pre-emptive capacity and the decision making process and ensure the independence of audits and the elimination of bias in information clearinghouse flows; and
4. **Independent audits and performance benchmarks** performed by groups that are not politically motivated and which do not have a vested stake in the outcome of audits. Evaluation of economic policy and performance in general and of progress towards designated development objectives specifically would be performed. These "country disclosure reports" could function like annual and quarterly reports of private sector companies and would reinforce government accountability (of both donor and recipient countries) and build confidence in the investor community.

The Global Clearinghouse will use leading-edge communication and internet technologies to improve communication, and the sharing of information and analytics between governments, international organizations, investors, and analysts worldwide – in effect improving and streamlining the "information plumbing" of the global financial system.

All interested parties should contact:

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The Global Clearinghouse in Support of the Monterrey Consensus

"We encourage public/private initiatives that enhance the ease of access, accuracy, timeliness and coverage of information on countries and financial markets, which strengthen capacities for risk assessment."

"These public/private initiatives could include the development of consultation mechanisms between international and regional financial organizations and national governments with the private sector in both source and recipient countries as a means to create business-enabling environments."

"…there is the need for the relevant international and regional institutions as well as appropriate institutions in source countries to increase their support for private foreign investment in infrastructure development and other priority areas, including projects to bridge the digital divide, in developing countries and countries with economies in transition. To this end, it is important to provide export credits, co-financing, venture capital and other lending instruments, risk guarantees, leveraging aid resources, information on investment opportunities, business development services, fora to facilitate business contacts and cooperation between enterprises of developed and developing countries, as well as funding for feasibility studies."

Monterrey Consensus Declaration of UN Member Countries
February, 2002

Over the past years there has been increased focus on the prevention of financial crises in emerging markets as well as increased focus on the appropriate role of the private sector in the resolution of those crises when they do occur. One recommendation, elaborated most recently by IMF First Deputy Director Anne Krueger,[6] is that such crises might best be resolved through an international equivalent of domestic bankruptcy proceedings. The agenda for the Conference included the objective of examining such an "international debt workout mechanism…modeled on domestic bankruptcy procedures, that will engage debtors and creditors to come together to restructure unsustainable debts in a timely and efficient manner"[7] and then presenting a description of such mechanisms and their feasibility to policymakers.[8]

SIA has consistently endorsed equitable "burden sharing"[9] in sovereign debt rescheduling. We applaud the efforts that the IMF and the US Treasury have made and are continuing to make in order to strengthen the architecture of the international financial system,[10] particularly the emphasis that has placed on crisis prevention, increased transparency and voluntary market-oriented solutions to debt problems. We also applaud the official willingness to engage private sector representatives on these issues and the courage of individuals such as US Treasury Secretary O'Neill, Ms. Krueger and Mr. Taylor to advance original ideas on these problematic issues. Earlier this year the SIA hosted a meeting, attended by both private sector and public sector representatives, intended to contribute to the ongoing dialogue on mechanisms for sovereign debt workouts. Many of the ideas discussed during that and subsequent meetings were were presented at a SIA-sponsored panel discussion at the Conference.[11] However, the views presented at the Conference panel and summarized below reflect the latter's charge to organize a discussion on the feasibility of implementing international bankruptcy mechanisms and present the findings for discussion purposes to the Conference participants.

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6 Krueger, A., "New Approaches to Sovereign Debt Restructuring: An Update on Our Thinking", Address to the Conference on Sovereign Debt Workouts: Hopes and Hazards, Institute for International Economics, Washington, D.C., April 1, 2002 (www.imf.org/external/np/speeches/2002/040102.htm). Also "Sovereign Debt Restructuring: A U.S. Perspective", Remarks by John B. Taylor, Under Secretary of Treasury for International Affairs, At the Conference on Sovereign Debt Workouts: Hopes and Hazards, Institute for International Economics, Washington, D.C., April 2, 2002 (www.ustreas.gov/press/releases/po2056.htm).

7 United Nations, "Monterrey Consensus" Document, Paragraph 53.

8 "International Debt Work-Outs and International Bankruptcy Mechanisms" Panel on March 19, 2002. Panelists included: Sean Hagan, IMF; Richard Gitlin, Bingham, Dana, LP, and; Frank Fernandez, SIA.

9 International Councils of Securities Associations (ICSA), "Private Burden Sharing: A Voluntary Approach", November 1999, http://www.sia.com/international/html/burden.html. Also see the "ICSA Communique 2002", http://www.icsa-intl.com/html/march_02_communique.html and "Reform of the Architecture of the International Financial System", http://www.stern.nyu.edu/~nroubini/asia/architecture.htm.

10 Letter to Horst Kohler from SIA, EMTA, IPMA/ISMA/TBMA (**ATTACHMENT THREE**), which was later endorsed by other organizations such as ICI.

11 "International Debt Work-Outs and International Bankruptcy Mechanisms" Panel.

Indeed, SIA's conclusion, on the basis of the views presented at the Conference, is that not only would constructing an international bankruptcy mechanism be cumbersome and take a very long time but that, such a solution might prove both unnecessary and undesirable in sovereign debt workout situations.[12] A less centralized, market-based approach is clearly preferable to private sector participants. Indeed, market participants have already outlined approaches that demonstrate that a market-based process to resolve sovereign debt defaults is not just possible but eminently workable. Experience has shown that inter-creditor equity, collective action and "cooling-off" periods can be achieved through contractual means that would have the support of bondholders and which thus avoid many of the difficulties associated with the more "mechanistic" ex-ante approaches advanced by the official sector. These difficulties include, for example, the inherent uncertainties of collective action clauses that might purport to apply across broad categories of yet unindentified bond issues or "stays" imposed on the basis of criteria identified long prior to an actual default. Such departures from the necessity of a case-by-case real-time examination of the facts of a particular country default pose grave difficulties for market participants.

The Conference presentation examined how an international bankruptcy mechanism might be created – the required amendments to the IMF articles of incorporation, to member state national law, and in turn, the necessity of creating different classes of creditors with different status and voting rights with respect to an ultimate plan of reorganization. The drawbacks of such a mechanism – the absence of a "court" with enforcement power (other than, perhaps the IMF which has inherent conflicts of interest because of its simultaneous role as significant creditor), the inability to marshall the debtor's assets for the benefit of creditors, the inability to change "management" or to liquidate the debtor and distribute its assets – were all discussed. It was also noted that even were all interest groups to agree on the basic idea and and the above issues to be satisfactorily resolved, such a complex scheme would likely take decades to move through the IMF and the parliaments of the member states.

The Conference seminar also examined the various contractual, legislative and market-based proposals to address sovereign debt workouts that have been discussed in recent months. The question of whether collective action clauses, which permit less than 100% of bondholders to change payment terms on bonds, would in fact considerably streamline sovereign workouts was actively debated. While the role of "holdouts" in sovereign defaults appears to be a matter of great concern to the official sector, the private sector, by contrast, believes that the holdout problem has been much exaggerated and that "holdouts" do not pose a threat to the orderly resolution of sovereign debt crises. Private sector participants are, for the most part, comfortable with collective action clauses, so long as the percentages are set sufficiently high to ensure consensus and to exclude the influence of sovereign-controlled bondholders on the process.

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12 See Proceedings from the Conference (forthcoming UN publication) for comments from the panel discussion, see footnote 8 above.

The effects of collective action clauses on minority shareholders was also discussed. There is general agreement that, if the percentages in collective action clauses are set high enough, it is not inappropriate for the minority bondholders to be bound by the super-majority's decision. This result is consistent with the result in domestic bankruptcy regimes where minority creditors are bound by an approved plan. The Conference session did explore whether mechanisms might be developed to protect minority holders' rights (such as, for example, the mechanism of rights of appraisal under Delaware Corporate Code [Art. 262]). However, it was concluded that such mechanisms would probably be both impractical and inappropriate – especially if full disclosure to bondholders was made concerning the terms of the collective action clauses.

In conclusion, while arguably feasible, it does not appear necessary or desirable to proceed in the direction of international bankruptcy mechanisms. An ad-hoc, market-driven approach to debt rescheduling exercises has served well in the past and appears to continue to be adequate to the task, especially if certain incremental changes are made to bond documents that could make the task of organizing creditors and making changes to payment terms somewhat easier. It was agreed that the principal problem impeding progress in both emerging market crisis prevention and resolution remains the inability and/or unwillingness of governing officials of problem debtors to institute, in a timely fashion, necessary stabilization measures and more long-term and broad-based reforms, including regular and fuller disclosure, necessary to induce lenders to provide additional financial support and the absence of means to compel them to do so other than withholding that support, which sometimes serves only to worsen existing problems. Clearly, more attention to these pressing issues is needed.

For further reference, see also "Sovereign Bonds and the Collective Will," by Lee C. Buchheit and G. Mitu Gulati, Working Paper Series, Georgetown-Sloan Project on Business Institutions, Georgetown University Law Center, Washington, DC.

ATTACHMENT ONE

KEY STANDARDS FOR SOUND FINANCIAL SYSTEMS*

[Summary]

The 12 standard areas highlighted here have been designated by the FSF as key for sound financial systems and deserving of priority implementation depending on country circumstances. While the key standards vary in terms of their degree of international endorsement, they are broadly accepted as representing minimum requirements for good practice. Some of the key standards are relevant for more than one policy area, e.g. sections of the Code of Good Practices on Transparency in Monetary and Financial Policies have relevance for aspects of payment and settlement as well as financial regulation and supervision.

Macroeconomic Policy and Data Transparency

Area	Standard	Issuing Body
Monetary and financial policy transparency	Code of Good Practices on Transparency in Monetary and Financial Policies	IMF
Fiscal policy transparency	Code of Good Practices in Fiscal Transparency	IMF
Data dissemination	Special Data Dissemination Standard/ General Data Dissemination System[1]	IMF

Institutional and Market Infrastructure

Area	Standard	Issuing Body
Insolvency	[2]	World Bank
Corporate governance	Principles of Corporate Governance	OECD
Accounting	International Accounting Standards (IAS)[3]	IASC[4]
Auditing	International Standards on Auditing (ISA)	IFAC[4]
Payment and settlement	Core Principles for Systemically Important Payment Systems Recommendations for Securities Settlement Systems	CPSS/ IOSCO
Market integrity	The Forty Recommendations of the Financial Action Task Force/8 Special Recommendations Against Terrorist Financing	FATF

Financial Regulation and Supervision

Area	Standard	Issuing Body
Banking supervision	Core Principles for Effective Banking Supervision	BCBS
Securities regulation	Objectives and Principles of Securities Regulation	IOSCO
Insurance supervision	Insurance Core Principles	IAIS

Footnotes

[1] Economies with access to international capital markets are encouraged to subscribe to the more stringent SDDS and all other economies are encouraged to adopt the GDDS.

[2] The World Bank is co-ordinating a broad-based effort to develop a set of principles and guidelines on insolvency regimes. The United Nations Commission on International Trade Law (UNCITRAL), which adopted the Model Law on Cross-Border Insolvency in 1997, will help facilitate implementation.

[3] Relevant IAS are currently being reviewed by the IAIS and IOSCO.

[4] The International Accounting Standards Committee (IASC) and the International Federation of Accountants (IFAC) are distinct from other standard-setting bodies in that they are private sector bodies.

Updated 4 April 2002

* Financial Stability Forum (FSF)	http://www.fsforum.org/
This document can be found at:	http://www.fsforum.org/Standards/KeyStds.html
Full text available at:	http://www.fsforum.org/Standards/Repiscsfs.html

ATTACHMENT TWO

THE COMMITTEE ON PAYMENT AND SETTLEMENT SYSTEMS (CPSS)[1]

Summary

Two main endeavors seem to be the **Core Principles for Systemically Important Payment Systems**[2] (which was finalized in 2001) and **Recommendations for Securities Settlement Systems**,[3] which they did jointly with IOSCO and gathered comments on them though 2001.

A number of international initiatives are under way which aim to maintain financial stability by strengthening the financial infrastructure. The International Organization of Securities Commissions (IOSCO) has developed the Objectives and Principles of Securities Regulation (IOSCO, 1998) and the Committee on Payment and Settlement Systems (CPSS) of the central banks of the Group of Ten Countries has just produced the final version of the Core Principles for Systemically Important Payment Systems (BIS, 2001).

These Core Principles identify what should govern the design and operation of payment systems in all countries. The Task Force developed an international consensus on such principles. It comprised representatives not only from the G10 central banks and the European Central Bank, but also from 11 other national central banks of countries in different stages of economic development from all over the world and representatives from the International Monetary Fund and the World Bank. In developing universal principles, it consulted groups of central banks in Africa, the Americas, Asia, the Pacific rim and Europe. Building on the previous work, the CPSS and IOSCO are now aiming to contribute further to this process by jointly developing recommendations for securities settlement systems, to improve the safety and efficiency of these systems.

In order to move this initiative forward, the CPSS and IOSCO created the Task Force on Securities Settlement Systems in December 1999. The Task Force comprises 28 central bankers and securities regulators from 18 countries and regions and from the European Union. In addition, at an early stage of its work the Task Force received input from central bankers and securities regulators who together represented about 30 countries, as well as from representatives of the International Monetary Fund and the World Bank. The Task Force has also reviewed private sector efforts in this area, notably the Group of Thirty's 1989 Standards, and has discussed the Task Force's work with private sector operators of and participants in securities settlement systems.

The present consultative report on the design, operation and oversight of securities settlement systems identifies, in 18 headline recommendations and accompanying explanatory texts, the minimum requirements that such systems should meet and the best practices that they should strive for. The recommendations are designed to cover systems for all types of securities, for securities issued in both industrialised and developing countries, and for domestic as well as cross-border trades. The report also includes key questions pertaining to each of the recommendations as an important first step towards establishing a methodology for assessing the extent to which they have been implemented. The answers to these questions are intended to provide a basis for a narrative evaluation of whether the recommendations for securities settlement systems have been implemented.

The CPSS and IOSCO are now releasing the recommendations in this report for consultation, and are seeking public comments from all interested parties by 9 April 2001. We believe that wide participation in the planned public consultation process should make the report most fruitful and we therefore encourage any interested parties to submit their comments to the Task Force. The Task Force will review the comments and develop the final recommendations in due course.

FOOTNOTES

1 http://www.bis.org/cpss/

2 **Core Principles for Systemically Important Payment Systems** (finalized, 2001): http://www.bis.org/publ/cpss43.htm

3 **Recommendations for Securities Settlement Systems**, done jointly with IOSCO and gathered comments on them though 2001: http://www.bis.org/publ/cpss42.htm

ATTACHMENT THREE

SIA EMTA IpMA IsMA TBMA

February 6, 2002

Mr. Horst Kohler
Managing Director
International Monetary Fund
700 19th Street NW
Washington, DC 20431

Dear Mr. Kohler:

This letter is in response to a recent proposal by First Deputy Managing Director Anne Krueger on a new approach to sovereign debt restructuring. We applaud the efforts that the IMF has made and is continuing to make in order to strengthen the architecture of the international financial system, particularly the emphasis that the IMF has placed on crisis prevention, increased transparency and voluntary and market-oriented solutions to debt problems. Unfortunately, the proposal advanced by Ms. Krueger would represent a step backward in the area of crisis resolution, because it would threaten legitimate creditor rights and severely interfere with the voluntary and market-based resolution of sovereign financial crises. Indeed, we are concerned that the principal effect of Ms. Krueger's proposal will be to further reduce the flow of private portfolio capital to developing countries, resulting in lower rates of growth and higher levels of poverty in developing countries with consequent spillover effects in the developed world.

Concerning the proposal itself, we would like to comment on several issues. First, we disagree strongly with several of the key assumptions that were used by Ms. Krueger as the basis for her proposal: (1) that there is a collective action problem preventing creditors as a group from reaching agreement on restructuring terms for countries that have an "unsustainable" level of external debt; (2) that IMF assistance to debtor governments has the effect of "bailing out" private creditors; and (3) that the proposed framework offering a debtor country legal protection from creditors would be analogous to domestic bankruptcy procedures.

We believe that the so-called collective action problem is more theoretical than real. Since this problem was first identified, debtor countries such as Russia, Ecuador, Pakistan and Ukraine have successfully been able to restructure all or a substantial portion of their external bonds through the use of exchange offers, which in some cases were accompanied by exit consents to encourage full participation. Experience has shown that so-called rogue creditors have not obstructed these restructurings. Even in the most widely cited (and possibly only) example of 'rogue" behavior, a single creditor in fact failed to disrupt Peru's restructuring in 1997 and only collected payment three years later. Accordingly, we believe that the danger of rogue creditors has been highly exaggerated. On the contrary, the more tangible danger may be in the overly aggressive use by debtor countries of exit consents to compel creditor participation in sovereign restructurings.

At the same time it is important to point out that the restructuring process can work only when both sides face appropriate incentives and disincentives. In her paper Ms. Krueger noted the success of 1980's debt rescheduling effort without acknowledging that the success of those efforts were due, in part, to a balance of rights and potential actions that brought both debtors and creditors to the negotiating table and helped to keep them there. We believe that Ms. Krueger's proposal would upset this balance by severely eroding creditors' rights while also possibly giving debtor governments the incentive to seek an officially sanctioned debt restructuring rather than making painful but necessary choices regarding their economic policies.

We also disagree with the argument that private creditors have been bailed out through official loans to developing countries. Far from being "bailed out", private creditors have and undoubtedly will continue to experience substantial losses on their exposure to emerging market sovereign debtors who have experienced payments difficulties. Meanwhile, multilateral and bilateral official creditors, in particular the IMF and the IBRD, have not absorbed comparable losses and have managed to maintain their position at the head of the payments queue.

Finally, we disagree strenuously with the notion that the mechanism envisioned by Ms. Krueger could be considered as analogous to a domestic bankruptcy procedure. According to the Krueger proposal, the IMF would effectively act like a bankruptcy court by endorsing a standstill so that it would be able to review the country's proposed economic policies. However, in addition to enforcing creditor standstills and mandating a creditor agreement, in a normal bankruptcy the court is also able to force the debtor to restructure its business and marshal its assets in order to satisfy valid creditor claims. Moreover, creditors have the ability to attach a debtor's assets, which can be used for full or partial recovery of their claims. These types of creditor protections, an integral part of an effective bankruptcy regime, are either not feasible or are severely limited under the Kreuger proposal.

Instead of a mechanism to ensure that creditors receive full or partial restitution of their claims, the Kreuger proposal implies that creditors will benefit from the adoption of IMF-mandated economic policies in the debtor country. However, severely compromising creditors' rights in exchange for an unenforceable promise by debtor countries to put in place policies that would prevent future payments interruptions is a trade-off that few creditors, with good reason, would accept voluntarily. The history of sovereign defaults, particularly in the past two decades, is filled with similar promises that were not fulfilled. More often than not, IMF targets set for debtor countries have not been met and structural adjustment programs linked to debt relief have lapsed without achieving the needed reforms. In addition, Ms. Krueger proposes that any new debt issued by the borrower would have to have seniority over existing debt, as a means to encourage private lenders to extend credit to the country. Existing creditors, as a result, would see the value of their claims on the borrower further diluted.

An additional concern with the proposal is the inherent conflict of interest that the IMF would face if the proposal were put into effect. The IMF, a principal creditor itself and agent of other official creditors to the troubled debtor, would also be acting as an arbitrator since it would decide when a debt standstill would be officially sanctioned and would in effect oversee the debt restructuring process. This inherent conflict of interest raises substantial concerns throughout the private sector about the legitimacy of the IMF's role as an impartial arbiter under the proposal.

In closing, we would like to stress once again that we believe more can be done to strengthen the architecture of the international financial system, particularly in the area of crisis prevention. Moreover, we strongly believe that the most constructive approach to both crisis prevention and resolution is through enhanced dialogue and cooperation between public and private sector creditors. One important lesson that has been learned over the past few years is that sovereign debt negotiations proceed at a faster pace, with less extraneous distractions, when there is trust and dialogue between the official sector and private creditors. The IMF itself has recognized the importance of improved dialogue between the official sector and private creditors as a means to smooth the restructuring process. In that respect, this proposal represents a step backward since it is clearly prejudicial toward the interests of private sector creditors. IMF support for the Krueger proposal, therefore, could drive a wedge between official and private creditors, weakening the basis for cooperation in the future.

Sincerely,

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