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DEBT RESTRUCTURING INTERNATIONAL PROPOSAL

Problem: The 10 most heavily indebted developing countries owe approximately $55 billion in debt to 9 major U.S. banks, and $260 billion to major commercial banks throughout the industrial world. The debt service burdens exceed the abilities of these developing nations to make current principal and interest payments, thus hindering new capital investment and economic growth. In turn, the failure to meet current principal and interest payments threatens the health of many of the world's banks because of the prospect of reduced bank profits and capital. The debt service burden also causes a market perception of creditor banks as greater investment risks.

Objectives:

Create an entity, an international insurance fund, that will be the focal point for debt negotiations. The function of this entity will be to assist the world's banks to increase risk-adjusted returns, enhance capital formation, and increase investor confidence. In turn, for debtor developing countries, the entity will provide realistic and substantiable debt repayment schedules, access to new money for economic growth, and will eliminate the current stalemate in dealing with developing country debt.

DRAFT

Summary of Proposal:

The International Debt Insurance Fund (IDI) would be created to provide a coinsurance system to guarantee debt. The IDI would be capitalized with initial contributions and guarantees from the banks, the creditor governments (proportional to debt held by their banks), and international organizations, and would be funded with periodic premium assessments paid by the banks. These capital contributions would be refunded as covered debt is retired. Debtor countries would also be required to continue economic reforms to obtain new insured credit. Old debt would be restructured with lengthened maturities and reduced payments (perhaps as 30 year notes at 60% to 70% of current loan values). This restructuring would provide for the full amortization of principal over that period. Creditor countries would foster a regulatory and tax environment to encourage these reductions. In exchange for debt reduction, the insurance system would coinsure repayment of the debt and interest at the new reduced levels.

PROPOSAL

Specifics:

1. Establish IDI. Create IDI owned by banks, international organizations and creditor governments to insure international bank debt of developing countries. (To be managed by a multinational board appointed by capital contributors.)

2. Capitalization. Capitalize IDI with callable capital, on terms defined by the IDI, contributed by banks, creditor governments, IMF, and World Bank. Creditor governments would provide callable capital or limited guarantees in proportion to the insured debt held by banks incorporated in their countries.

3. Coinsurance. IDI coinsures the risks with banks. Losses would be shared between banks and IDI, perhaps with the banks taking a small initial loss (a deduction) before sharing would begin. IDI will define terms identifying when loss occurs, and insurance payable.

4. Premiums. Banks pay premiums to IDI based on country, type of loan, insured bank covered, and the amount of debt reduction negotiated by the bank. Premium levels will be set by IDI. Premium levels will be adjusted annually within limits based on past year's experience and potential liability of the IDI.

5. Debt Reduction. Banks restructure debt with developing countries on a voluntary basis to meet levels required. IDI provides guidance on debt reduction levels and sets amount of reduction needed to obtain levels of insurance. IDI also sets a deadline for banks to join as insurees. Nonparticipating banks are precluded from joining IDI after deadline. IDI may encourage greater debt reductions by increasing its share of coinsurance in exchange for greater levels of debt reduction.

6. Economic Reform. IDI (working with international organizations) helps negotiate with developing countries on economic reform program objectives and goals taking long-term perspective into consideration. Monitoring of the economic reform programs would be done through the IMF and the World Bank.

7. New Loans. IDI coinsures new loans only if the developing country has made certifiable economic progress entitling country to insurance coverage for the year involved. New insured loans have equals priority with loans initially part of debt reduction, coinsurance program. Institutions can extend new loans on an insured basis only to the extent that they, their government, or international organizations contribute additional capital to the IDI according to a formula established by the IDI. Only certain types of new loans may receive insurance, such as, for example, trade financing, but not balance-of-payments financing.

8. Senior Obligations. To provide a further incentive for banks to participate in IDI, insured developing country debt is made senior, through collateral pledges to the extent permitted by law, to uninsured obligations, (i.e., obligations of banks not participating in the debt reduction coinsurance program.) This is important to minimize any "free rider" problem.

9. Payments of Claims. After the bank's initial coinsurance obligation is exhausted, to the extent such an obligation/deduction may be required, obligations of IDI are met first from premium income, then investment income, and then from capital pledges.

10. Regulatory and Tax Policy. Each country sets regulatory and tax policies to encourage bank's voluntary participation. For example, regarding the U.S., this could include raising ICERC mandated reserve levels for loan losses to encourage all banks to participate in this program (presumably reserves would not be required for reduced/insured debt). The tax structure would also be modified to facilitate reduction, including regarding more liberal NOL and alternative minimum tax treatment, as well as through clarification of certain types of tax treatment, especially regarding reserves and partial charge-offs for debt reduction. Insured debt would be accorded special treatment under the risk-based capital guidelines.

ADVANTAGES OF IDI APPROACH

Advantages to Debtor Developing Countries:

A. Facilitate debt repayment at realistic and sustainable levels through extended amortization periods, and significant principal and interest payment reductions.

B. Attract new sources of capital through loans from banks participating in coinsurance programs.

C. Eliminate the need for continuous short-term negotiations.

D. Enhance longer-term economic and political stability.

E. Permit continuation of case-by-case approach to developing country debt that rewards those countries that undertake necessary economic reforms.

Advantages to Banks:

A. Profitability --

* Return existing loans to performing status.
* Provide new lending to developing countries -- a new source of insured earning assets.
* Modify existing tax laws to reduce the earnings impact of using current reserves for loan losses to cover initial debt reduction.

* Improve risk-adjusted rates of return, thus facilitating new lower cost capital.

B. Capital Formation --

* Restore investor confidence by reducing risk exposure on developing country debt.
* Reduce future capital requirements under new risk-based capital standards to the extent of the insured debt portion.
* Increased credit ratings on funds as a result of coinsurance.

<u>Advantages to Creditor Governments:</u>

A. Economic growth -- restoration of debtor countries to economic health will mean improved market for exports of developed countries.

B. Financial stability -- removal of uncertainties in financial markets.

C. Increased tax revenues -- avoidance of further losses by banks will mean higher taxable income in future years.

D. Political benefits -- free market forces in debtor countries should be strengthened, and political stability should be increased.

NOTES ON THE DEBT SERVICING EXAMPLES

1. Two examples of how an International Debt Insurer (IDI) might function are included. Both examples use Mexico as the debtor country. The "Bank X" case represents the exposure of an average U.S. money-center bank; the other case uses exposure data for all banks (U.S. and foreign) reporting to the Bank for International Settlements (BIS). The latter example is the closest approximation of Mexico's total bank debt. Each case consists of a scenario for the first five years of the insurance program, and a summary of the respective schedules for amortization of the debt and capitalization of the IDI.

2. The values used in the accompanying examples for discounts, guarantees, etc, are not recommendations; they are used for illustrative purposes only. Many assumptions were simplified in order to streamline the examples.

3. The amortization examples assume that all payments on the restructured debt are made on schedule; in practice, there may be instances where a debtor is temporarily unable to make scheduled payments, necessitating calls on banks' deductibles and possibly IDI insurance. Banks' insurance premiums would not be a fixed annual amount, but would vary according to the past year's loss experience. In addition, banks would take the first loss on any debt servicing shortfall through the deductibles, premium payments and their share of initial IDI capital contributions.

4. As insured debt is retired through compliance with the restructured debt service obligations, initial contributions to capitalize the IDI would be refunded, as would bank premium payments. An example is the Debt Amortization Schedule for all B.I.S.-reporting banks. Assuming complete compliance with the restructured debt service obligations over the first twelve years of the program, the IDI insurance fund would exceed the present discounted value of the remaining debt service guarantees by $781 million. Thus, the insurance fund would be able to cover all of the remaining debt service obligations from years thirteen through twenty (assuming no new insured loans are made) without any additional premium payments. Additions and deletions to the pool of insured loans would alter the point at which the insurance fund could cover the remaining guarantees, as would changes in the degree of compliance, or changes in the premium assessment rate. The timing of the above-mentioned rebates would be agreed upon at the beginning of the program.

5. Exposure data are as of September 30, 1988.

MEXICO EXAMPLE - EXPLANATION OF ASSUMPTIONS
(Corresponds to Attached Outline for All BIS Reporting Banks)

ELIGIBLE DEBT

Only medium- and long-term bank debt (no short-term trade financing) is eligible for restructuring, and this eligible debt represents 75 percent of Mexico's bank debt outstanding. As of September 30, 1988, Mexico's total debt to banks was approximately $69.742 billion; therefore, $52.307 billion would be eligible for restructuring.

RESTRUCTURED DEBT DISCOUNT

Current annual debt service and discounted annual debt service are estimated by treating obligations as a 20-year annuity, with full amortization of respective principal amounts. The current interest rate on the $52.3 billion of eligible debt is assumed to be 11 percent, so that current annual debt service on the eligible debt is $6.568 billion.

In this example, all eligible debt is tendered for restructuring. Creditors may choose the magnitude of discount they will offer; the greater the discount offered, the greater the share of the coinsurance that is borne by the IDI. The total debt reductions for Type "A" debt (where banks discount Mexico's debt service by 40 percent in exchange for 80 percent IDI coverage of the discounted annual debt service) and Type "B" debt (where banks discount debt service by 30 percent in exchange for 70 percent coverage of the discounted annual debt service) represent the percentage reductions in annual debt service. These reductions are achieved by reducing the principal amount and fixing the interest rate at a reduced level -- 8 percent in this example. We assume that half of the eligible debt -- $26.153 billion -- is offered as Type A debt and half as Type B debt, so that the overall debt service discount is 35 percent. Therefore, the current annual debt service -- $6.568 billion -- is discounted to $4.269 billion.

COINSURANCE

The IDI guarantees 80% of the discounted annual debt service on Type A debt, and 70 percent of the discounted annual debt service on Type B debt (the Annual Guaranteed Amount); therefore, in this example, the total annual guaranteed amount equals 75 percent of the discounted annual debt service -- $3.185 billion. The remainder of the discounted annual debt service -- $1.084 billion -- is the creditor banks' deductible share. If all scheduled payments are made, or if any annual payments shortfalls do not exceed the banks' deductible share ($1.084 billion per year), then there will be no claims on IDI coinsurance.

PREMIUM

Banks' premium payments are equal to their coinsurance share (20% for Type A, 30% for Type B, 25% total) of the expected annual debt service shortfall, assuming a 10 percent probability of total nonpayment on the restructured debt in any year. This greatly simplified model recognizes only two possible outcomes in any year -- either total payment of discounted annual debt service or total nonpayment.

CAPITAL CONTRIBUTION

We assume that the initial capital contribution to the IDI is equal to two years of the annual guaranteed debt service payments ($3.185 billion x 2 = $6.37 billion). In this example, the initial capital is provided by the multilateral development institutions (IMF, World Bank) and the creditor banks. The banks' share of the initial capital contribution would be drawn upon first in the event of a debt service shortfall that exceeded their deductible and accumulated premiums.

CALLABLE CAPITAL AND GUARANTEES

The callable capital and guarantees are equal to the guaranteed portion of the discounted annual debt service payments remaining to maturity, less banks' remaining insurance premium payments and the existing amount of the IDI fund. They represent the debt service guarantees that exceed the insurance reserve plus the remaining insurance premium payments, and are expressed in present value terms using a 9% discount rate.

TOTAL DEBT SERVICE REDUCTIONS

The total debt service reductions in this example (35 percent, or $2.299 billion per year over 20 years) equal the difference between the assumed current annual debt service ($6.568 billion) and the discounted annual debt service ($4.269 billion). At the end of 20 years, these reductions would total $45.98 billion.

INSURANCE RESERVE

The insurance reserve is equal to the initial capitalization of the IDI ($6.37 billion), plus annual premium payments ($80 million per year). The reserve is assumed to compound annually at a rate of 9 percent.

CAVEATS

Our examples of restructured Mexican debt servicing assume that all debt service obligations are met, so that there are no drawdowns of the IDI fund. Also, for the sake of simplicity, no new insured debt is incurred in the period covered by the examples, although it is likely that the prospect of coinsurance for new loans will attract additional new financing.

BANK: BIS - Reporting Banks

COUNTRY: Mexico

TOTAL DEBT OUTSTANDING: $69,742

ELIGIBLE DEBT: $52,307

ORIGINAL INTEREST RATE: 11%

REDUCED INTEREST RATE: 8%

(All dollar amounts are in the millions, unless otherwise noted)

RESTRUCTURED DEBT DISCOUNT

	Par Value of Debt	Current Annual Debt Service	Discounted Annual Debt Service	Discounted Principal
Type A (40%)	$26,153	$3,284	$1,970	$19,342
Type B (30%)	$26,153	$3,284	$2,299	$22,572
Total (35%)	$52,307	$6,568	$4,269	$41,914

COINSURANCE

	Annual Guaranteed Amount	Banks' Deductible
Type A (80-20)	$1,576	$394
Type B (70-30)	$1,609	$690
Total	$3,185	$1,084

PREMIUM: (Equal to 25% of the expected debt service shortfall per year.)
Assumption: Prob (total failure to service debt) = 10%
then: E (Annual debt service shortfall) = (0.1) * (Total Guaranteed Amount)
then: Annual Premium = $80

CAPITAL CONTRIBUTION: $6,370

IMF	$2,548	(40% of total)
World Bank	$2,548	(40% of total)
Banks	$1,274	(20% of total)

CALLABLE CAPITAL AND GUARANTEES: $21,974

TOTAL DEBT SERVICE REDUCTIONS:

$2,299 per year (35%)

$2,299 cumulative

INSURANCE RESERVE: $6,450

BANK: All B.I.S. - Reporting Banks COUNTRY: Mexico

TOTAL DEBT OUTSTANDING: ELIGIBLE DEBT:

ORIGINAL INTEREST RATE: 11% REDUCED INTEREST RATE: 8%

(All dollar amounts are in the millions, unless otherwise noted)

RESTRUCTURED DEBT DISCOUNT

	Par Value of Debt	Current Annual Debt Service	Discounted Annual Debt Service	Discounted Principal
Type A (40%)			$1,970	$18,919
Type B (30%)			$2,299	$22,079
Total (35%)			$4,269	$40,998

COINSURANCE

	Annual Guaranteed Amount	Banks' Deductible
Type A (80-20)		
Type B (70-30)		
Total	$3,185	$1,084

PREMIUM: (Equal to 25% of the expected debt service shortfall per year.)
Assumption: Prob (total failure to service debt) = 10%
then: E (Annual debt service shortfall) = (0.1) * (Total Guaranteed Amount)
then: Annual Premium = $80

CAPITAL CONTRIBUTION:

IMF	(40% of total)
World Bank	(40% of total)
Banks	(20% of total)

CALLABLE CAPITAL AND GUARANTEES: $21,420

TOTAL DEBT SERVICE REDUCTIONS:

$2,299 per year (35%)

$4,598 cumulative

INSURANCE RESERVE: $7,110

BANK: ALL U.S. - Reporting Banks COUNTRY: MEXICO

TOTAL DEBT OUTSTANDING: ELIGIBLE DEBT:

ORIGINAL INTEREST RATE: 11% REDUCED INTEREST RATE: 8%

(All dollar amounts are in the millions, unless otherwise noted)

RESTRUCTURED DEBT DISCOUNT

	Par Value of Debt	Current Annual Debt Service	Discounted Annual Debt Service	Discounted Principal
Type A (40%)			$1,970	$18,463
Type B (30%)			$2,299	$21,545
Total (35%)			$4,269	$40,008

COINSURANCE

	Annual Guaranteed Amount	Banks' Deductible
Type A (80-20)		
Type B (70-30)		
Total	$3,185	$1,084

PREMIUM: (Equal to 25% of the expected debt service shortfall per year.)
Assumption: Prob (total failure to service debt) = 10%
then: E (Annual debt service shortfall) = (0.1) * (Total Guaranteed Amount)
then: Annual Premium = $80

CAPITAL CONTRIBUTION:

IMF	(40% of total)
World Bank	(40% of total)
Banks	(20% of total)

CALLABLE CAPITAL AND GUARANTEES: $20,156

TOTAL DEBT SERVICE REDUCTIONS:

$2,299 per year (35%)

$6,897 cumulative

INSURANCE RESERVE: $7,830

BANK: All B.I.S. - Reporting Banks COUNTRY: Mexico

TOTAL DEBT OUTSTANDING: ELIGIBLE DEBT:

ORIGINAL INTEREST RATE: 11% REDUCED INTEREST RATE: 8%

(All dollar amounts are in the millions, unless otherwise noted)

RESTRUCTURED DEBT DISCOUNT

	Par Value of Debt	Current Annual Debt Service	Discounted Annual Debt Service	Discounted Principal
Type A (40%)			$1,970	$17,970
Type B (30%)			$2,299	$20,970
Total (35%)			$4,269	$38,940

COINSURANCE

	Annual Guaranteed Amount	Banks' Deductible
Type A (80-20)		
Type B (70-30)		
Total	$3,185	$1,084

PREMIUM: (Equal to 25% of the expected debt service shortfall per year.)
Assumption: Prob (total failure to service debt) = 10%
then: E (Annual debt service shortfall) = (0.1) * (Total Guaranteed Amount)
then: Annual Premium = $80

CAPITAL CONTRIBUTION:

IMF	(40% of total)
World Bank	(40% of total)
Banks	(20% of total)

CALLABLE CAPITAL AND GUARANTEES: $18,778

TOTAL DEBT SERVICE REDUCTIONS:

$2,299 per year (35%)

$9,196 cumulative

INSURANCE RESERVE: $8,615

BANK: All B.I.S. - Reporting Banks COUNTRY: Mexico

TOTAL DEBT OUTSTANDING: ELIGIBLE DEBT:

ORIGINAL INTEREST RATE: 11% REDUCED INTEREST RATE: 8%

(All dollar amounts are in the millions, unless otherwise noted)

RESTRUCTURED DEBT DISCOUNT

	Par Value of Debt	Current Annual Debt Service	Discounted Annual Debt Service	Discounted Principal
Type A (40%)			$1,970	$17,438
Type B (30%)			$2,299	$20,349
Total (35%)			$4,269	$37,787

COINSURANCE

	Annual Guaranteed Amount	Banks' Deductible
Type A (80-20)		
Type B (70-30)		
Total	$3,185	$1,084

PREMIUM: (Equal to 25% of the expected debt service shortfall per year.)
Assumption: Prob (total failure to service debt) = 10%
then: E (Annual debt service shortfall) = (0.1) * (Total Guaranteed Amount)
then: Annual Premium = $80

CAPITAL CONTRIBUTION:

IMF	(40% of total)
World Bank	(40% of total)
Banks	(20% of total)

CALLABLE CAPITAL AND GUARANTEES: $17,275

TOTAL DEBT SERVICE REDUCTIONS:

$2,299 per year (35%)

$11,495 cumulative

INSURANCE RESERVE: $9,470

BANK: Bank X (Average U.S. Money Center)

COUNTRY: Mexico

TOTAL DEBT OUTSTANDING: $1,366

ELIGIBLE DEBT: $1,025

ORIGINAL INTEREST RATE: 11%

REDUCED INTEREST RATE: 8%

(All dollar amounts are in the millions, unless otherwise noted)

RESTRUCTURED DEBT DISCOUNT

	Par Value of Debt	Current Annual Debt Service	Discounted Annual Debt Service	(Beginning of year) Discounted Principal
Type A (40%)	$512.5	$64.36	$38.62	$379.18
Type B (30%)	$512.5	$64.36	$45.05	$442.31
Total (35%)	$1025	$128.72	$83.67	$821.49

COINSURANCE

	Annual Guaranteed Amount	Bank Deductible
Type A (80-20)	$30.90	$7.72
Type B (70-30)	$31.54	$13.51
Total	$62.44	$21.23

PREMIUM: (Equal to 25% of the expected debt service shortfall per year.)
Assumption: Prob (total failure to service debt) = 10%
then: E (Annual debt service shortfall) = (0.1) * (Total Guaranteed Amount) = $6.244
then: Annual Premium = $1.561

CAPITAL CONTRIBUTION: $124.90

IMF	$49.96	(40% of total)
World Bank	$49.96	(40% of total)
Bank	$24.98	(20% of total)

CALLABLE CAPITAL AND GUARANTEES: $430.84 (PDV)

TOTAL DEBT SERVICE REDUCTIONS:

$25.74 per year (35%)

$25.74 cumulative

INSURANCE RESERVE: $126.46

BANK: Bank X COUNTRY: Mexico

TOTAL DEBT OUTSTANDING: ELIGIBLE DEBT:

ORIGINAL INTEREST RATE: 11% REDUCED INTEREST RATE: 8%

(All dollar amounts are in the millions, unless otherwise noted)

RESTRUCTURED DEBT DISCOUNT

	Par Value of Debt	Current Annual Debt Service	Discounted Annual Debt Service	Discounted Principal
Type A (40%)			$38.62	$371
Type B (30%)			$45.05	$432
Total (35%)			$83.67	$803

COINSURANCE

	Annual Guaranteed Amount	Bank Deductible
Type A (80-20)		
Type B (70-30)		
Total	$62.44	$21.23

PREMIUM: (Equal to 25% of the expected debt service shortfall per year.)
Assumption: Prob (total failure to service debt) = 10%
then: E (Annual debt service shortfall) = (0.1) * (Total Guaranteed Amount)
then: Annual Premium = $1.561

CAPITAL CONTRIBUTION:

IMF	(40% of total)
World Bank	(40% of total)
Bank	(20% of total)

CALLABLE CAPITAL AND GUARANTEES: $407.04 (PDV)

TOTAL DEBT SERVICE REDUCTIONS:

__________ per year (35%)

$51.48 cumulative

INSURANCE RESERVE: $139.40 (compounded)

BANK: Bank A COUNTRY: Mexico

TOTAL DEBT OUTSTANDING: ELIGIBLE DEBT:

ORIGINAL INTEREST RATE: 11% REDUCED INTEREST RATE: 8%

(All dollar amounts are in the millions, unless otherwise noted)

RESTRUCTURED DEBT DISCOUNT

	Par Value of Debt	Current Annual Debt Service	Discounted Annual Debt Service	Discounted Principal
Type A (40%)			$38.62	$362
Type B (30%)			$45.05	$422
Total (35%)			$83.67	$784

COINSURANCE

	Annual Guaranteed Amount	Bank Deductible
Type A (80-20)		
Type B (70-30)		
Total	$62.44	$21.23

PREMIUM: (Equal to 25% of the expected debt service shortfall per year.)
Assumption: Prob (total failure to service debt) = 10%
then: E (Annual debt service shortfall) = (0.1) * (Total Guaranteed Amount)
then: Annual Premium = $1.561

CAPITAL CONTRIBUTION:

IMF	(40% of total)
World Bank	(40% of total)
Bank	(20% of total)

CALLABLE CAPITAL AND GUARANTEES: $381.08 (PDV)

TOTAL DEBT SERVICE REDUCTIONS:

__________ per year (35%)

$77.22 cumulative

INSURANCE RESERVE: $153.51 (compounded)

BANK: Bank X | COUNTRY: Mexico

TOTAL DEBT OUTSTANDING: | ELIGIBLE DEBT:

ORIGINAL INTEREST RATE: 11% | REDUCED INTEREST RATE: 8%

(All dollar amounts are in the millions, unless otherwise noted)

RESTRUCTURED DEBT DISCOUNT

	Par Value of Debt	Current Annual Debt Service	Discounted Annual Debt Service	(Beginning of year) Discounted Principal
Type A (40%)			$38.62	$352
Type B (30%)			$45.05	$411
Total (35%)			$83.67	$763

COINSURANCE

	Annual Guaranteed Amount	Bank Deductible
ype A (80-20)		
Type B (70-30)		
Total	$62.44	$21.23

PREMIUM: (Equal to 25% of the expected debt service shortfall per year.)
Assumption: Prob (total failure to service debt) = 10%
then: E (Annual debt service shortfall) = (0.1) * (Total Guaranteed Amount)
then: Annual Premium = $1.561

CAPITAL CONTRIBUTION:

IMF	(40% of total)
World Bank	(40% of total)
Bank	(20% of total)

CALLABLE CAPITAL AND GUARANTEES: $352.80 (PDV)

TOTAL DEBT SERVICE REDUCTIONS:

__________ per year (35%)

$102.96 cumulative

INSURANCE RESERVE: $168.89 (compounded)

BANK: Bank X

COUNTRY: Mexico

TOTAL DEBT OUTSTANDING:

ELIGIBLE DEBT:

ORIGINAL INTEREST RATE: 11%

REDUCED INTEREST RATE: 8%

(All dollar amounts are in the millions, unless otherwise noted)

RESTRUCTURED DEBT DISCOUNT

	Par Value of Debt	Current Annual Debt Service	Discounted Annual Debt Service	Discounted Principal
Type A (40%)			$38.62	$342
Type B (30%)			$45.05	$398
Total (35%)			$83.67	$740

COINSURANCE

	Annual Guaranteed Amount	Bank Deductible
Type A (80-20)		
Type B (70-30)		
Total	$62.44	$21.23

PREMIUM: (Equal to 25% of the expected debt service shortfall per year.)
Assumption: Prob (total failure to service debt) = 10%
then: E (Annual debt service shortfall) = (0.1) * (Total Guaranteed Amount)
then: Annual Premium = $1.561

CAPITAL CONTRIBUTION:

IMF	(40% of total)
World Bank	(40% of total)
Bank	(20% of total)

CALLABLE CAPITAL AND GUARANTEES: $321.97 (PDV)

TOTAL DEBT SERVICE REDUCTIONS:

__________ per year (35%)

$128.70 cumulative

INSURANCE RESERVE: $185.65 (compounded)

EXAMPLE: MEXICO
DEBT AMORTIZATION SCHEDULE -- ALL B.I.S. - REPORTING BANKS
(AMOUNTS IN $ MILLION)

YEAR	DEBT SERVICE PAYMENTS PRINCIPAL	INTEREST	TOTAL	OUTSTANDING PRINCIPAL BALANCE*	INSURANCE RESERVE	REMAINING DEBT SERVICE GUARANTEES* (NET OF IDI RESERVE)
1	916	3,353	4,269	41,914	6,450	21,974
2	989	3,280	4,269	40,998	7,110	21,420
3	1,068	3,201	4,269	40,009	7,830	20,156
4	1,154	3,115	4,269	38,941	8,615	18,778
5	1,246	3,023	4,269	37,787	9,470	17,275
6	1,346	2,923	4,269	36,541	10,402	15,638
7	1,453	2,816	4,269	35,195	11,418	13,854
8	1,570	2,699	4,269	33,742	12,526	11,909
9	1,695	2,574	4,269	32,172	13,733	9,788
10	1,831	2,438	4,269	30,477	15,049	7,477
11	1,977	2,292	4,269	28,646	16,483	4,958
12	2,136	2,133	4,269	26,669	18,047	2,212
13	2,306	1,963	4,269	24,533	19,751	(781)
14	2,491	1,778	4,269	22,227	21,609	(4,044)
15	2,690	1,579	4,269	19,736	23,633	(7,600)
16	2,905	1,364	4,269	17,046	25,840	(11,476)
17	3,138	1,131	4,269	14,141	28,246	(15,701)
18	3,389	880	4,269	11,002	30,868	(20,306)
19	3,670	609	4,269	7,614	33,726	(25,326)
20	3,954	316	4,269	3,954	36,841	(30,797)

*Balances at beginning of year.

EXAMPLE: MEXICO
DEBT AMORTIZATION SCHEDULE -- BANK X (AVERAGE MONEY CENTER)
(AMOUNTS IN $ MILLION)

YEAR	DEBT SERVICE PAYMENTS PRINCIPAL	INTEREST	TOTAL	OUTSTANDING PRINCIPAL BALANCE*	INSURANCE RESERVE	REMAINING DEBT SERVICE GUARANTEES* (NET OF IDI RESERVE)
1	17.95	$65.72	$83.67	$821.49	$126.46	$430.84
2	$19.39	$64.28	$83.67	$803.54	$139.40	$407.04
3	$20.94	$62.73	$83.67	$784.15	$153.51	$381.08
4	$22.61	$61.06	$83.67	$763.21	$168.89	$352.80
5	$24.42	$59.25	$83.67	$740.60	$185.65	$321.97

*All balances at beginning of year.

Withdrawal/Redaction Sheet
(George Bush Library)

Document No. and Type	Subject/Title of Document	Date	Restriction	Class.
01. Paper	From Nick Brady to John Sununu Re: Tax Treatment of Ethyl Tertiary Butyl Ether (ETBE) (2 pp.)	7/20/89	~~P-5~~	

Collection:

Record Group: Bush Presidential Records
Office: Chief of Staff, White House Office of
Series: Sununu, John, Files
Subseries: Cabinet Agencies Files
WHORM Cat.:
File Location: Brady (Treasury - 1989)

Open on Expiration of PRA
(Document Follows)
By JP (NLGB) on 5/12/05

Date Closed:	12/1/2004	**OA/ID Number:**	29186-009
FOIA/SYS Case #:	1998-0004-F[1]	**Appeal Case #:**	
Re-review Case #:	2005-0426-S	**Appeal Disposition:**	
P-2/P-5 Review Case #:		**Disposition Date:**	
AR Case #:		**MR Case #:**	
AR Disposition:		**MR Disposition:**	
AR Disposition Date:		**MR Disposition Date:**	

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P-1 National Security Classified Information [(a)(1) of the PRA]
P-2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P-3 Release would violate a Federal statute [(a)(3) of the PRA]
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C. Closed in accordance with restrictions contained in donor's deed of gift.

PRM. Removed as a personal record misfile.

Freedom of Information Act - [5 U.S.C. 552(b)]

(b)(1) National security classified information [(b)(1) of the FOIA]
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TAX TREATMENT OF ETBE

Issue: IRS has been asked to rule that ethanol used in the production of Ethyl Tertiary Butyl Ether (ETBE), an octane enhancer for gasoline, qualifies for the 60-cents-per-gallon income tax credit allowed by Code section 40.

Legal Considerations: Under a strict technical construction of section 40, ethanol used to make ETBE seems not to qualify. Section 40 allows a credit for ethanol used to make a mixture of ethanol and either gasoline or another motor fuel. ETBE is a compound that is produced in a chemical reaction between ethanol and isobutylene (a petroleum product) and then blended with gasoline. Because ethanol loses its chemical identity in this process, no such mixture is ever produced. A tariff provision enacted at about the same time is consistent with this strict interpretation. ETBE supporters argue that the credit should be construed broadly to accomplish its purpose and that the chemical transformation of ethanol in making ETBE should not matter.

Policy Considerations: ETBE supporters argue that its use would reduce air pollution, conserve gasoline, and help farmers by increasing demand for ethanol, which is made from corn. Opponents argue that ETBE would merely displace MTBE, a competing octane enhancer which is made from methanol and is not eligible for any credit or other subsidy. MTBE also reduces air pollution and saves gasoline. (It is understood, however, that EPA believes ETBE has some slight environmental advantage over MTBE.) Opponents of a ruling argue that allowing the credit would, by subsidizing a product that could not compete in the free market, distort the economy and misallocate resources. Unless tariff laws are changed, much of the benefit of extending the credit may go to imported ETBE, because it is not subject to the duty that offsets the credit for imported ethanol.

Political Considerations: More than 70 Senators wrote to Secretaries Baker and Brady last year to urge a favorable ruling. However, some later informally withdrew their support. It is understood that Presidential Counsel Boyden Gray and Agriculture Secretary Yeutter support a favorable ruling. EPA Administrator Reilly and Energy Secretary Watkins have contacted Treasury to describe the benefits of ETBE use. Some original supporters (including Sen. Dole) now do not want a ruling unless tariff laws are changed to keep out imported ETBE. Finance Committee members Bradley and Rockefeller, and Ways and Means members Archer and Schulze, oppose a ruling. Chairman Rostenkowski has stated that the ETBE issue should be resolved legislatively rather than by a ruling and wants to hold hearings. Producers of methanol (which is made from natural gas) oppose a favorable ruling because they fear that the credit would permit ETBE to displace MTBE.

Estimated Revenue Loss: $574m (FY90-94). The loss would increase if clean air requirements are expanded, and also is sensitive to changes in the prices of ethanol, methanol, and petroleum.

July 20, 1989

Office of Tax Policy
Department of the Treasury

John

Yea or nay

Love and kisses

NFB

(Nick Brady)

Rec'd COS
JUL 20 1989
5:00 pm

Withdrawal/Redaction Sheet
(George Bush Library)

Document No. and Type	Subject/Title of Document	Date	Restriction	Class.
02. Memo	From Hollis McLaughlin to Secretary Brady Re: Briefing for Meeting w/POTUS (5 pp.)	10/2/89	P/5	

Collection:

Record Group: Bush Presidential Records
Office: Chief of Staff, White House Office of
Series: Sununu, John, Files
Subseries: Cabinet Agencies Files
WHORM Cat.:
File Location: Brady (Treasury - 1989)

Open on Expiration of PRA
(Document Follows)
By JP (NLGB) on 12/12/07

Date Closed:	12/1/2004	**OA/ID Number:**	29186-009
FOIA/SYS Case #:	1998-0004-F[1]	**Appeal Case #:**	
Re-review Case #:	2005-0426-S	**Appeal Disposition:**	
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October 2, 1989

MEMORANDUM FOR SECRETARY BRADY

FROM: Hollis S. McLoughlin
Assistant Secretary for Policy Management

SUBJECT: Briefing for Meeting with the President

DATE AND TIME: Monday, October 2, 1989, at 3:30 p.m.

LOCATION: The White House

PARTICIPANTS: The President
Secretary Brady

OVERVIEW: Issues to be raised with The President:

1. Competitiveness Study
2. Money Laundering
3. IMF/World Bank

BRIEFING: Talking Points

TALKING POINTS
MEETING WITH THE PRESIDENT
October 2, 1989

1. Competitiveness

A. BANKS

o In last 20 years the ranking (by size) of U.S. banks has declined. Of 20 largest banks by assets, only 1 is U.S. Bank size may not be only measure of competitiveness, but it is important.

o We must determine what activities are needed to allow our banks to compete successfully in global marketplace. Fewer limitations on permitted activities (underwriting securities, geographical branching) apply to banks in other countries.

o As the EC countries reexamine their banking laws as part of EC 92, we have to reexamine ours as well. We must decide how to alter Glass-Steagall (separate commercial and investment banking) and McFadden (restrict inter-state branching) to keep our banks globally competitive.

o Clarify/simplify regulatory structure for financial institutions (Fed, OCC, OTS, FDIC) and financial markets (SEC, CFTC, Fed) to minimize barriers to innovation.

o Coordinate/update clearance and settlement (cross-margining, 3-day securities settlement, clarify bankruptcy laws)

o Develop institutional mechanism for international cooperation among securities regulators, exchanges, central banks.

B. GENERAL

o U.S. corporations have a higher cost of capital (cost of debt and equity) than corporations of major trading partners.

-- Estimates are around 100% higher than Japanese companies, 50% higher than German

- o Higher cost of capital cripples competitive position of U.S. firms. Must earn higher rates of return to cover cost. Could stand in way of funding important new projects -- for example, new silicon chip plant, new R&D facility.

- o Fact that U.S. makes interest payments tax deductible but not dividend payments, makes U.S.firms substitute debt for equity to decrease taxes. One reason for LBO's.

- o Secretary of the Treasury has begun to speak out on how to reduce U.S. cost of capital.

  -- reduce Federal Government deficit

  -- reduce capital gains tax

  -- eliminate double taxation of dividends (either by making dividends deductible or by giving shareholders credit for tax paid by corporations)

  -- resist making any corporate interest payments non-deductible

  -- increase personal savings rate

    -- some form of IRA is leading candidate

- o EPC has formed a Working Group on Savings of Cost of Capital under Treasury direction

2. Money Laundering

- o Treasury chaired money laundering center is "going live".

  Called FINCEN (Financial Crimes Enforcement Center), the Center will conduct comprehensive data gathering and analysis on money laundering.

  FINCEN is a multiagency effort that will draw resources from various departments and bureaus and will work closely with the Drug Czar.

- o The first meeting of the money laundering task force agreed to by the heads of state at the Paris Economic Summit was held two weeks ago in Paris. John Robson headed the U.S. delegation. He is optimistic that an action-oriented, hard hitting set of recommendations will be submitted for consideration by heads of state and finance ministers at the 1990 Economic Summit.

- o Discussions are going forward but are still in early stages on the U.S. Mexico money laundering agreement (discussed at the mini-summit in Mexico).

3. <u>IMF/World Bank</u>

A. Critical Juncture in the Debt Strategy

-- Progress achieved (Mexico, Philippines), but need to push ahead (Venezuela, Costa Rica, Morocco).

-- <u>Cannot implement strategy without strong support from IMF and World Bank and cannot expect such support without U.S. funding.</u>

B. IMF

-- IMF quota negotiations 1 1/2 years behind schedule.

-- Committed to reaching a decision by year-end. Must stick by commitment.

-- Possible U.S. contribution $10-$13 billion. Budget authority, but <u>no budget outlay</u>.

-- Very difficult issue politically - little support on the Hill.
  - o IMF has no constituency.
  - o Many argue no urgent need, since IMF has reasonable amount of resources.

-- Failure to agree to increase would critically damage debt strategy and IMF's ability to support countries such as Mexico, the Philippines, and Poland.

-- Could, however, consider agreement this year but delay implementation until fiscal year 1992 (calendar year 1991), after next congressional elections.

C. WORLD BANK

-- World Bank also has major role in debt strategy. Two major challenges for us:

- o Funding for World Bank and other MDB's this year (FY 1990) to clean up arrears and meet ongoing commitments; $414 million in arrears to MDB's. Could still have $200 million in arrears after FY 90 appropriations. The World Bank and the IDB have been "zeroed" in the House. Puts us in impossible situation on debt strategy.

- Commitment to a new replenishment of IDA (World Bank soft loan window). Problems here as well:

  Large budget hit (approximately $1 billion per year); World Bank under heavy criticism on environment and salaries;

  Can we commit to major new replenishment before we have cleared up existing arrears to MDB's.

~~CONFIDENTIAL~~

8

DEPARTMENT OF THE TREASURY
WASHINGTON
November 16, 1989

file

UNDER SECRETARY

MEMORANDUM FOR SECRETARY BRADY

FROM: David C. Mulford
Under Secretary, International Affairs

CHD Dallara
Charles H. Dallara
Assistant Secretary, International Affairs

SUBJECT: Poland and the IMF

This is in response to your question concerning the status of discussions between the IMF and Poland, an issue which arose during the course of the meeting yesterday with the President. These are the facts.

1. On Monday morning (November 13), you asked Dallara to call General Scowcroft to provide him a detailed briefing on the status of Poland's discussions with the IMF.

2. Dallara called General Scowcroft that morning, and he returned the call later that afternoon. Dallara gave the General a detailed briefing on the status of the Fund's discussions with Poland, indicating that we had been monitoring these discussions closely and encouraging the Fund to move as fast as possible. Scowcroft indicated that Chancellor Kohl had suggested to the President that a program for Poland might be agreed by the end of November. Dallara responded that this date seemed unrealistic, based on his most recent conversations with the Fund. Indications prior to the latest Fund Mission suggested, in fact, that January might be a more realistic timetable for agreement. Dallara then briefed the General on the status of our efforts to obtain other countries' support for the $1 billion Stabilization Fund.

3. Later that night, we received a report from the IMF Mission indicating that they had made very good progress in their talks in Warsaw, and were now operating on an accelerated timetable, with the aim of having agreement between Poland and Fund Management by mid-December.

4. Tuesday morning (the 14th), Dallara called Tim Deal, NSC staff, to inform him fully of the progress being made and the advanced timetable to mid-December, although this could slip to January. Dallara indicated that he would encourage the Fund and the Poles to work quickly to meet the December timetable.

~~CONFIDENTIAL~~

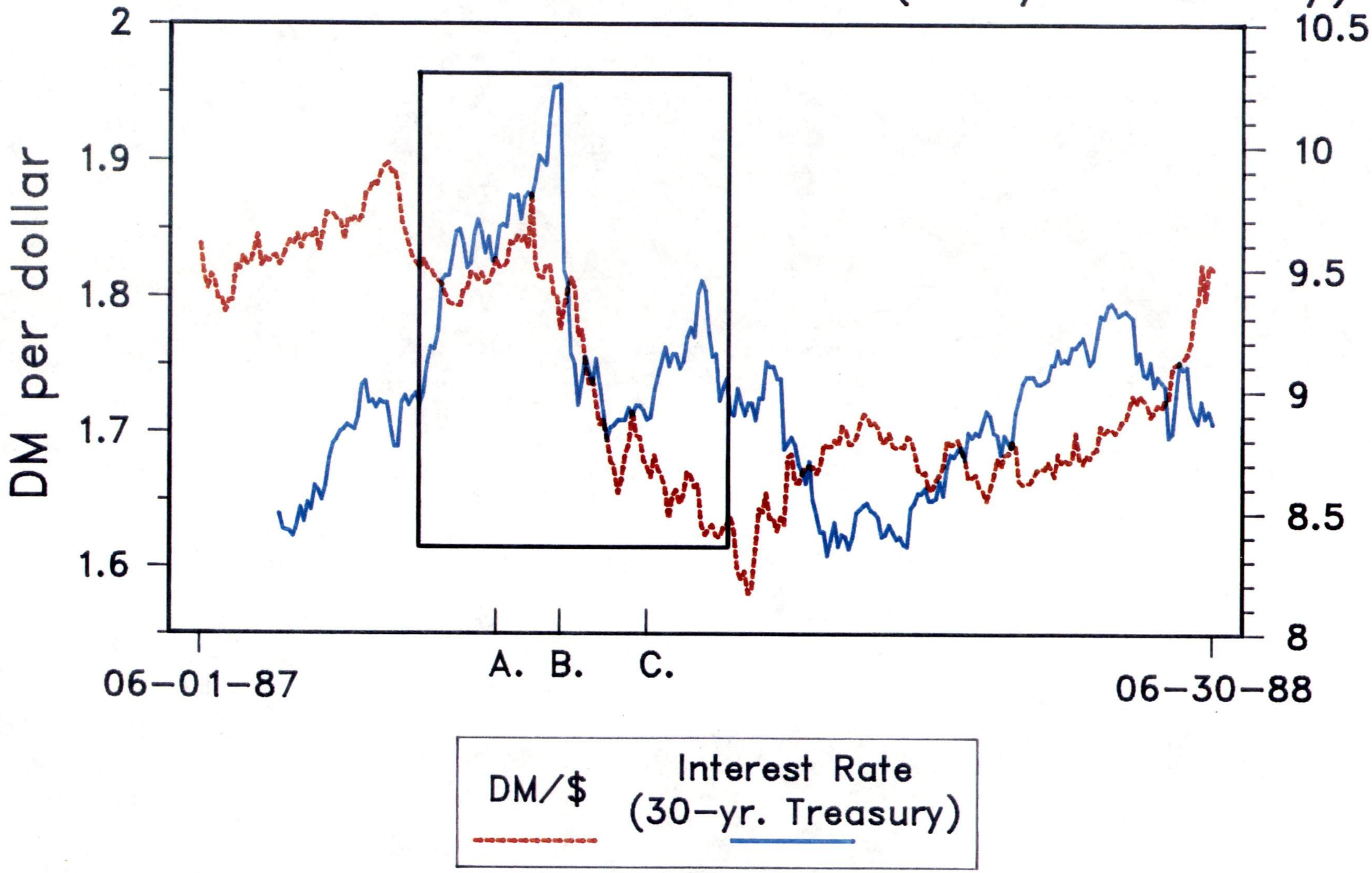
5. Later that day (Tuesday), Dr. Mulford and Assistant Secretary Dallara discussed Poland with the IMF's Managing Director, Michel Camdessus. Camdessus confirmed that the Fund was aiming to reach agreement by mid-December. We encouraged him to make every effort toward that end, and discussed how the $1 billion Stabilization Fund and a possible bridge loan might fit into the timetable.

6. The next morning (Wednesday, November 15), Dr. Mulford and Assistant Secretary Dallara discussed a variety of issues with the Polish Finance Minister. The Minister confirmed that they also hoped to reach agreement by mid-December, but that a number of important decisions needed to be made by the Polish Government. We underscored the importance of making those decisions in order that the Fund Mission which is scheduled to return to Warsaw in early December could conclude the agreement. We also discussed current U.S. efforts with the G-7 to put together a bridge loan for Poland, fitted to their reform plans.

7. Following the meeting with the President Wednesday afternoon, Dallara called Tim Deal to confirm their conversation of this past Tuesday (where Dallara indicated that the Fund was now aiming for mid-December). Deal confirmed that he had passed this message to General Scowcroft and Mr. Gates in a note dated Tuesday, November 14.

8. This morning Dallara also spoke with Bob Gates who indicated he had not yet seen the note from Tim Deal, and therefore was operating on older information. He indicated that he would correct the misimpression with the President that had been left at the meeting yesterday.

Dollar vs. DM & Interest Rate (30-yr. Treasury)

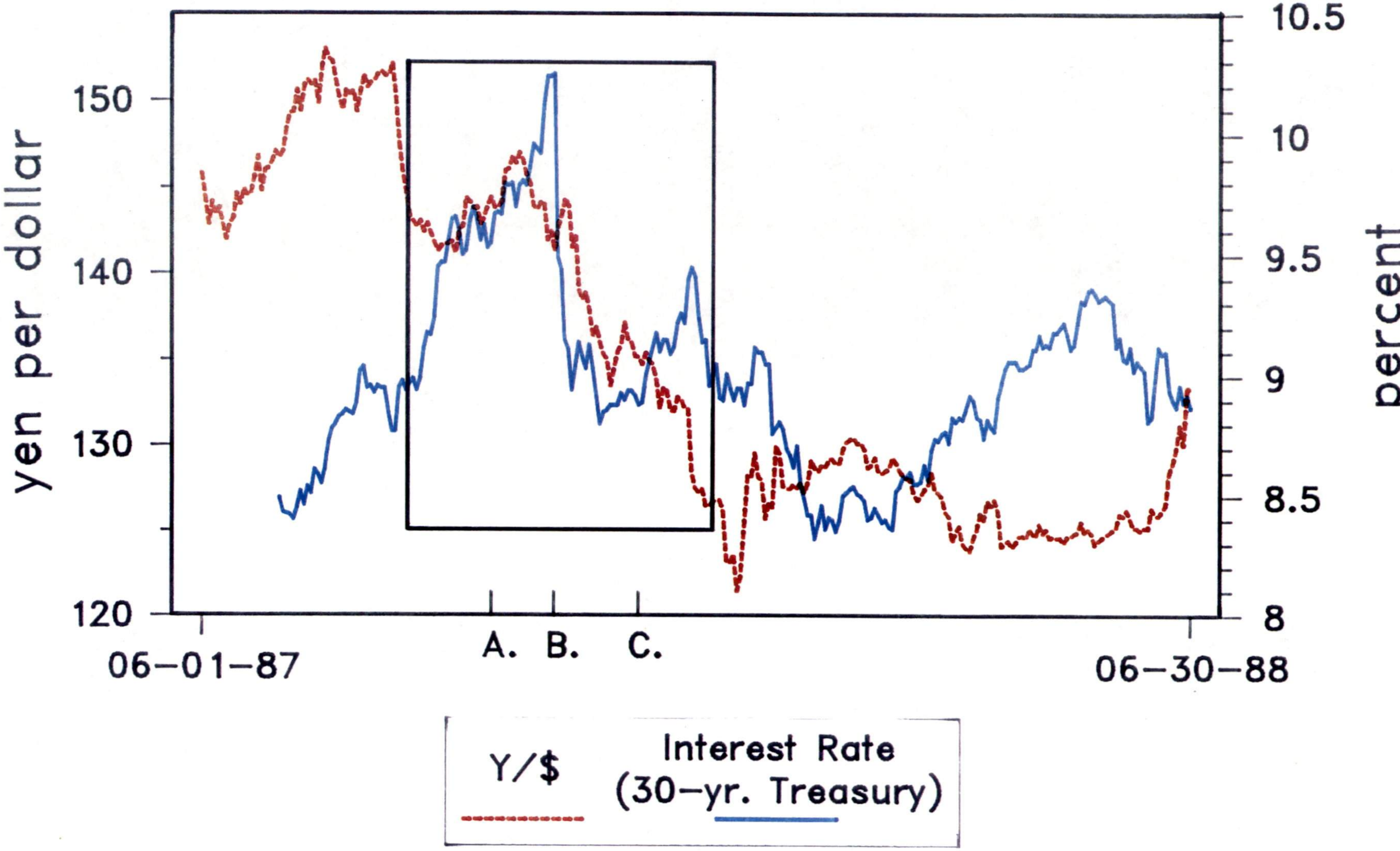


A. Gramm-Rudman Target Change (9-23-87)*
B. Stock Market Decline (10-19-87)
C. Budget Summit Agreement (11-20-87)

7/20/89

* Yearly deficit limits eased and zero deficit target moved to 1993 from 1991.

Dollar vs. Yen & Interest Rate (30-yr. Treasury)



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(George Bush Library)

Document No. and Type	Subject/Title of Document	Date	Restriction	Class.
04. Memo	From Hollis McLaughlin to Secretary Brady Re: Section 89 (6 pp.)	6/9/89	~~P-5~~	

Collection:

Record Group: Bush Presidential Records
Office: Chief of Staff, White House Office of
Series: Sununu, John, Files
Subseries: Cabinet Agencies Files
WHORM Cat.:
File Location: Brady (Treasury - 1989)

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DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

June 9, 1989

MEMORANDUM FOR: Governor Sununu

FROM: Hollis S. McLoughlin HSM
Assistant Secretary
(Policy Management)

SUBJECT: Section 89

At Secretary Brady request, I am forwarding Treasury's position on Section 89.

The attached document has been sent to OMB for clearance. This position is basically consistent with our previous testimony before the Ways and Means Committee. We continue to support the modification and simplification of Section 89 but not outright repeal.

PROPOSED MARK-UP POSITION

BENTSEN-PRYOR BILL TO SIMPLIFY SECTION 89 OF THE INTERNAL REVENUE CODE

STRUCTURE OF BILL. The Bentsen bill follows the structure of the Rostenkowski bill, but modifies several provisions in a manner that generally loosens the substantive requirements of the Rostenkowski bill. Generally, the two bills are identical in providing that:

(1) tax benefits would not be available for executive-only health plans (the "nondiscriminatory provisions test"), and

(2) affordable health care coverage must be made available by the employer to most employees in order to preserve the tax benefits of highly compensated employees (the "90 percent test").

The sanction for failure to meet these two tests is inclusion in the income of highly compensated employees of the cost of all employer-paid coverage. In addition, employer-paid health coverage for highly compensated employees is included in income of such employees to the extent the cost exceeds 133 percent of the amount of health coverage made available to most employees (the "133 percent test"). For purposes of the 90 percent test and 133 percent test, part-time and certain other employees may be excluded from consideration, and union and nonunion employees are to be considered separately.

A 34 percent excise tax is imposed on employers that fail to meet certain qualification requirements (e.g., plan must be written, legally enforceable, etc.) with respect to health and certain other welfare benefit plans.

SIGNIFICANT DIFFERENCES. The most significant of the differences between the two bills are listed below, along with the mark-up position recommended by the Treasury.

Effective Date

Bentsen: Repeals current section 89 and delays effective date of new section 89 until 1990. Employers have option to use current section 89 in 1990 and 1991.

Rostenkowski: Repeals current section 89 and makes new section 89 effective for 1989. Employers have option to use current section 89 during 1989.

we agree

Recommendation: Administration and compliance are greatly simplified by delaying effective date until 1990. Preliminary internal Treasury estimate places revenue cost of such delay at $20 million in 1989 and $57 million in 1990, which we consider acceptable. It may be necessary to find a 1989 revenue offset to avoid a budget point-of-order in the Senate.

24mm

<u>90 Percent Test</u>

Bentsen: Affordable core health coverage must be available to 90 percent of <u>all</u> non-excluded employees.

Rostenkowski: Affordable core health coverage must be available to 90 percent of non-excluded <u>nonhighly compensated</u> employees.

Excluded Employees: Both the Bentsen and Rostenkowski bills exclude certain employees from consideration under the 90 percent test. Bentsen's exclusions are significantly broader with respect to leased employees and employees of small businesses.

Cliff Effect: Bentsen and Rostenkowski bills both create a cliff effect, i.e., if availability falls below 90 percent, all of the tax benefits to highly compensated employees are lost. Bentsen addresses this problem indirectly by loosening the point at which the cliff kicks in, because it bases the 90 percent test on availability to all employees rather than to nonhighly compensated employees and provides broader exclusions.

Recommendation: Accept the Bentsen position, which is simpler and, thus, more attractive than the Rostenkowski position. In light of the generous exclusions in the Bentsen bill, we have concluded that the independent reasons to address the cliff effect, which are discussed below, should not be put forth at this time.

Alternative: Address cliff effect directly by proposing an alternative coverage test, a graded sanction for failing 90 percent test, or both. An alternative coverage test would waive the 90 percent test for an employer if more than 50 percent of its nonhighly compensated employees actually signed up for coverage under one or more of the employer's core health plans. A graded sanction for failing 90 percent test would involve either imposing an increasing excise tax or cutting back the 133 percent test to a 100 percent test for employers that still satisfy an 80 percent availability threshold.

Affordability

Bentsen: Core health coverage is considered affordable if the employee is not required to pay more than 40 percent of the entire premium for either single or family coverage.

Rostenkowski: Employee cost may not exceed $10 per week for single coverage or $25 per week for family coverage. Both figures are indexed to wage inflation.

Percentage Versus Dollar Cap: The advantage of a percent age cap is that it avoids the need for indexing and automatically adjusts for geographic and other market variations in health coverage costs. The drawback to a pure percentage cap is that it may invite abusive planning by permitting employers to make "available" very expensive coverage, 40 percent of the cost of which few employees can really afford.

A dollar cap indexed to wages rather than health inflation has been criticized as shifting the cost burden increasingly to the employer over time. Employers, however, could prevent this by buying less expensive coverage that imposes higher copayments and deductibles on employees. This is viewed as good health policy by some since it discourages first-dollar coverage while ensuring catastrophic coverage.

Recommendation: Accept Bentsen's 40 percent cap, recognizing that, if abuses occur, corrective legislation can be enacted at a later time.

Other Alternatives:

(1) Percentage cap with percentage-of-compensation limit.

(2) Pure dollar cap. If so, indexed to wages or health cost inflation?

(3) Pure dollar cap or percentage cap, with alternative of minimum percentage.

Salary Reduction

Bentsen: For 90 percent test, salary reduction contributions generally are treated as employee contributions. For 133 percent test, salary reduction contributions made by highly compensated employees generally are treated as employer contributions and salary reduction contributions made by nonhighly compensated employees are treated as employee contributions. Two exceptions to the treatment of salary reduction contributions are provided. First, for purposes of the 133 percent test, such contributions made by nonhighly compensated employees are treated as employer contributions if the employer provides a contribution that is at least as great as the amount of the nonhighly compensated employee's salary reduction contributions. Second, cashable credits are treated as employer contributions only if such credits can be cashed when the employee certifies he has other health insurance. Cashable credits are those portions of the employer-paid premiums that an employer permits an employee to receive in cash compensation when an employee elects to receive such cash rather than health coverage.

Rostenkowski: Does not provide the two exceptions contained in Bentsen bill. Salary reduction contributions generally cannot be used in conjunction with a health plan subject to section 89.

Recommendation: Strongly oppose Bentsen "cashable credit" proposal, but adopt Bentsen's general salary reduction rule. We note that the effect of Bentsen's general salary reduction rule is to permit an employer to require an employee to pay a maximum of 70 percent of the premium.

__Small Business Rules__

Bentsen: The bill includes special rules for businesses with less than 20 employees. For example, if the health premiums for employees of such businesses are individually rated, the employer may consider the cost of each employee's premium to be the average premium cost. In addition, the definition of excludable employees is expanded.

Rostenkowski: None

Treasury proposal in hearing testimony: A business with less than 11 employees would pass section 89 if it has one health plan that is available to at least 90 percent of the nonhighy compensated employees so long as at least a majority of the nonhighly compensated employees participate in the plan.

Recommendation: We have not received many comments regarding our proposal and, thus, recommend supporting the Bentsen approach.

Excise Tax for Qualification Failure

Bentsen: 34 percent of the employer-paid premium, except there is an initial 6-month period to correct a failure without penalty.

Rostenkowski: 34% of the employer-paid premium.

Recommendation: Have a two-tiered penalty, with a 5 percent tax imposed from date of failure and a 34 percent tax imposed at a later date if there is no correction within a reasonable period after notice from the IRS.