Delivered - March 25, 2011

Report from the Contact Group on Certain Financing by Loss-Making Institutions

This is a descriptive report; hence, it makes no attempt to suggest possible solutions or to comprehensively reflect all the discussions held within the group.

The Contact Group included – Brazil, Canada, China, EU and US

It met 4 times – on 14 and 16 March, for internal discussions of the group, and on 17 March to discuss the draft report. On 16 March the group also held consultations with Australia, Japan and Turkey.

At the meetings, the Members exchanged views on the bracketed issue of "certain financing by loss-making institutions" based on the Chair's texts and on the "2008 non-paper" discussed in plurilateral meeting in November 2010.

The discussions held were without prejudice to national positions of the Members of the Contact Group, which range from opposition to the inclusion of new disciplines regarding certain financing by loss-making institutions to full support for it.

Members of the Contact Group made the following points

- The proposed language addresses situations more serious then those already covered in Article 14 (items a, b and c): equity, loan and loan guarantees

- The particular situations are characterized by the cumulative elements enumerated in the suggested language

- In the case of loans and loans guarantee by a government, the benefit shall be deemed to exist if (i) the <u>loans and loan guarantees</u> are provided (ii) by <u>government financial institutions</u> which (iii) <u>do not independently operate on a commercial basis</u> and benefit from (iv) <u>long-term government support</u> (v) to <u>state enterprises</u> (vi) <u>unable to obtain such financing</u> from commercial lenders

- In the case of the government provision of equity capital, the benefit shall be deemed to exist if (i) the <u>equity capital</u> is provided (ii) by <u>government financial institutions</u> which (iii) <u>do</u>

not independently operate on a commercial basis and benefit from (iv) long-term government support (v) to state enterprises (vi) inconsistent with usual investment practice of private investors.

- "Government financial institutions not independently operating on a commercial basis" means that the decisions of the financial institution reflect government industrial policy, for example, rather than a commercial rationale

- The focus of the new disciplines should also be on the recipient, not only in the government institutions, as it was the case in the 2007 Chair's text. The concept of benefit to the recipient should prevail.

- Neither the proposed language in the main paragraph nor its footnote is intended to interfere in the Members' financial sector prudential measures and the aim of the suggested footnote is to clarify that.

- Placement is an important element on the discussion of any new disciplines in the matter. There are different options with regard to placement of the new language: it could be in Article 14, in Article 3, in a revised "dark amber box", Article 1, or any other options Members may find more appropriate.

- The proposed disciplines are more disadvantageous to developing countries where the presence of the government, in both sides (government financing institution and state owned recipient), is more likely to happen to deal with "market failure" situations.

- It is also in developing countries where the need for interference and support from the government happens more systemically.

- The text would be more balanced if the continuous government support was not only related to "government financial institutions" but to all financial institutions, and if the financial provision involved not only "state enterprises" but to any uncreditworthiness or unequityworthiness enterprise (be it private or public).

- The proposed language does not entirely reflect the objectives expressed by the demanders.

- Unclear and/or imprecise concepts create discomfort and concerns regarding the extent of the new disciplines, for example:

(i) "not independently operating on a commercial basis" – what does "independently" entail?... since the idea of "decisions not reflecting a commercial rational" would already be covered by "not operating on a commercial basis".

(ii) "state enterprises" – what is the definition of a "state enterprise"?;

(iii) "unable to obtain from commercial lenders" – what would that expression entail? how would that situation be identified? what about the situations of "market failure"?

- The central elements of the recipients' uncreditworthiness and unequityworthiness are not reflected.

- It would contribute to the discussion if not only the concepts of uncreditworthiness and unequityworthiness were clearly stated in the proposed language but also some guidance was given on what those concepts would encompass. In that regard the US proposal GEN/146 was mentioned, with Members emphasizing the two footnotes stating the factors to be regarded when examining the concepts of creditworthiness and equityworthiness.

- Some doubts remain regarding the intent to address the uncreditworthiness of the enterprise as a whole or the uncreditworthiness of each particular project to which the loan or loan guarantee could be related to.

- The proposed language regarding the "usual investment practice of private investors" should refer to "private investors in the territory of that Member", as specified in Article 14(a).

- There should be no presumption that the appetite to finance state enterprises targeted by government industrial policies would not exist in commercial lenders and investors. Private commercial lenders and investors could also be more interested to provide loans and/or invest capital in those sectors targeted by government industrial policies, since the government policy would enhance the perspective of good performance (and good investment return) of such sectors.

- Since the new language seems to address the most egregious, systemic, long term situations, Article 14 may not be the best place to introduce the intended disciplines. This also raises the point of what would be the "benchmark" to calculate the benefit to the recipient.

- The new language should not interfere in the Members' financial sector prudential measures. The fact that the footnote makes direct reference to measures related to laws and regulations of general application raises concerns about the potential scope of the proposed language.

- The last line of the footnote, regarding the expertise of the panel members, should be deleted because this should be an overarching principle in all disputes.

Visitors' views

- Supportive of having the issue captured by future disciplines and based their comments on the "non-paper".

- Considered that the rules should apply not only to financing of "state enterprises" but any enterprises.

- Stressed the importance of the message in the suggested footnote. Legitimate government policies to stabilize capital markets should be carved-out from the disciplines.

- Some concepts would need further clarification: "long-term"; "independently"; "commercial basis"; "state enterprises" (and its relationship with "public body" in Article 1); "usual investment practice of private investors"; "prudential expertise" (expertise in measures taken for prudential reasons).

- Core elements of the new disciplines could include some or all of the following: "long-term" government support; institutions "not operating on a commercial basis"; "loss-making" financial institutions; uncreditworthy and unequityworthy enterprises. They believe they should be clearly stated in the new language.

- Regarding placement of the new language, three options were mentioned: Article 3, revised "dark amber box" (Article 6.1) and Article 14.

- The issue of expertise of panel members should be better placed in DS provisions.