

TO: David Luft, Policy Planning Staff

ROOM NO. 7312	BUILDING State
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REMARKS:

FYI -- Sid Zabudoff will be calling you about these papers.

FROM: Harry Rowen, C/NIC

ROOM NO. 7E62	BUILDING Hqs.	
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FORM NO. 241 1 FEB 55
 REPLACES FORM 36-B WHICH MAY BE USED. (47)

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MEMORANDUM FOR:

Henry Rowen,

FYI -- Two very interesting papers
on East European Debt by a friend who
runs a consulting firm.

[Redacted]

NIC/AG

David S. Seltzer

Date March 3, 1982

THE ROMANIA RESTRUCTURING--INTELLIGENCE REPORT

Several U.S. commercial bankers are meeting today, March 1st, in New York to discuss the "proposed restructuring arrangement" which is being fashioned between Romania and its eurobanking creditors.

Last week the nine most heavily committed banks "bought" the proposed arrangement. This group of banks from Germany, England, Switzerland, and France includes two American banks--Manufacturers Hanover with \$80 million of unguaranteed exposure and Bank of America with \$40 million of unguaranteed exposure. The plan presented to these banks has been worked out earlier last week in Bucharest by a commercial banker who has informally been serving as an adviser to the Romanians. This banker, Lee Kjelleren of Manufacturers Hanover, has sought to devise a scheme which will be acceptable to bankers given the present climate. Most bankers recognize that there is a strong likelihood that Yugoslavia, Hungary, and East Germany are likely to follow suit.

The scheme which apparently the nine most exposed banks have agreed to accept involves rescheduling 80 percent of the total \$2.8 billion of unguaranteed commercial bank debt. The payment period calls for a three year grace period and six and one-half years of payback. The proposed fee structure is 1.75 percent over LIBO plus a generous one percent front end

fee for agreeing to the rescheduling. The plan is to get the entire community of 312 banks to agree to the plan so that a signing can occur in May.

The 16 banks to hear the proposals today have collectively \$415 million of unguaranteed credits to Romania. Manufacturers Hanover Bank and Bank of America have nearly 30 percent of the total. The smallest three of the 16 banks have hardly any exposure whatsoever.

In effect, this restructuring is quite similar to the plan that is evolving for Poland. We understand that in the Polish case 95 percent of the unguaranteed bank debt is to be restructured. There will be a longer repayment period for Poland (effectively eight years).

In our judgment, the banks go along because they don't really see an alternative on the horizon. At least they get large front end fees which will boost this year's income together with agreements on the part of the borrower to remain current on interest charges and to continue cooperating with creditors in the future according to established rules of the game. It will be interesting to see how the bank regulators choose to classify these assets during the next round of examinations.

THE POLISH DEBT SITUATION--INTELLIGENCE MEMORANDUM
Perceptions of American Bankers

February 10, 1982

We talked this week with four U.S.-based eurobankers regarding the Polish debt situation. These are the views expressed by these senior lending officers and credit policy executives who asked not to be identified.

Everyone agrees that the situation is exceedingly complex largely because of the diversity of views and aspirations among the interested parties. The issue is not so much repayment of the debt, but the wide range of interest in the particular situation.

1. According to the U.S. bankers, the German banks want a quiet, "no fanfare" solution which will result in a stretching out of the debt into the future. The Germans recognize that the Poles certainly are unable to pay interest or principal now and are prepared to accept a lengthy stretch-out of payment terms--8 to 10 years.

2. The German Government also does not want to rock the boat for fear of jeopardizing the pipeline project.

3. The U.S. bankers would seem to be much more hard-nosed. They realize that without the imposition of substantial terms and conditions accompanying the stretch-out, there can be a very harmful precedent set in the

Polish situation. They continue to speak of the Nicaragua restructuring which is uniformly regarded as a fiasco from the commercial bankers' perspective. Poland could turn into a large scale Nicaragua which could then pose much more serious problems as other countries follow suit. There is an article in this week's Business Week which suggests that the American banks are displeased with the U.S. Government's assumption of the arrearages on the commodity credits. When questioned about this, I have been told that on the one hand the banks are pleased to see that the U.S. Government may provide a safety net in deteriorating situations yet they see the present "solution" as undermining a long established practice in which a country is first declared in default prior to settlement under the guarantee programs. The U.S. bankers are upset with the government's step in that they don't think the solution is in any sense permanent. This buying of time can only weaken the position of the U.S. banks vis-a-vis the European lenders with much larger Polish exposure. Also, the government stepping in this way will set a precedent which will make steering committee meetings more difficult in the future. There is, however, a diversity of views and almost an ambivalence on the part of individual bankers regarding the prospect of a Polish default. The four

bankers interviewed seemed to become weak-kneed when asked to consider the repercussions of a Polish default. They recognize that they will have little control over how many other defaults may be triggered by blowing the whistle in the Polish situation. I came away with the feeling that the bankers, like the U.S. Government, don't want to force the situation at this time because of the uncertainty.

4. The U.S. Government is perceived to be playing hard-nosed politics. In effect, we are saying officially, "Why should Poland be bailed out by us if this is part of the Soviet sphere of influence? Let the Russians pay!" The bankers go on to say that it is about time that the U.S. Government takes such a hard line. The bankers think the government hasn't forced a default yet because of the serious repercussions in Europe with the allies.

What the bankers see is a situation evolving in which the Europeans which hold most of the Polish debt, as well as the debt in other Eastern Bloc countries, will be prepared to work within a framework of a long-term restructuring. The American banks are fearful that they will have to go along, and this will be perceived both in the financial markets and by the bank regulators as deleterious to their financial

condition. The bankers are nervous about the next round of examinations by New York State, the OCC, and by the Federal Reserve. They are wondering how much in the way of additional bad debt reserves the regulators may require.

When asked what they think is going to happen in the Polish situation, the bankers seem to think that for the time being the hardliners in Washington will not win--we will not force Poland to default. The situation is likely to drift along for another few months until the next crisis point. No one sees how Poland will be able to meet debt servicing on its 1982 obligations, even interest payments. The bankers seem firm in their view that they will not go along with the 1982 rescheduling/restructuring which does not at least provide for interest payments on the 1982 debt. They see the 1982 debt service discussions--both Paris Club and Creditor Committee discussions--dragging on well into 1982 without any resolution. During the negotiations, they see the Poles seeking to call a halt to all payments. European banks may be willing to let it slide--this posture will certainly be resisted by the American bankers with whom we discussed the situation. The only perceived virtue of letting it slide is that the banks don't have to face the issue until perhaps there is another government or other players with a solution

in hand. Without a solution, the situation must drag on according to the bankers. As one banker put it, "You can't squeeze blood out of stone."

The bankers think the Polish situation may also be influenced by the imminent default/restructuring going on at this very moment concerning Rumania. In this instance, some of the U.S. banks have a significant stake although France is the big stakeholder. At least one U.S. bank has a branch in that country. They see the Rumanian situation as being perhaps even more problematic than the Polish situation--no explanation for this view was forthcoming.

When asked how this may affect the eurobanking system, the interviewees project a scenario along these lines. They don't see the Russians giving money to the Poles. The Germans probably are unable to fund the Poles due to other financial constraints. Certainly the U.S. is not going to fund Poland while the Germans and the Soviets sit on the sidelines. They stress that the banking system is fairly elastic and could certainly survive a Polish default, particularly the U.S. banks with their relatively small exposure to Poland. Even Bank of America with \$300 million could sustain a loss of this size so long as such losses don't occur too frequently. Herein lies the key. All the

bankers interviewed were concerned that there may well be an increased pace of restructurings and defaults. In other words, you could have several Polands within the space of perhaps six months. They cite the Rumanias, Senegal, Liberia, Turkey again, Peru, and Costa Rica to mention a few.

If you begin to have a number of defaults and again country lending moves onto the front pages of the newspapers, the euromarkets could again be under siege. They see the possibility that investors would begin pulling funds back and that the markets could become especially treacherous for the smaller players and new eurobanking names.

When asked about the Mideast banks and the role which they may play in such an eventuality or with regard to recycling in general, the American bankers' view is that they don't see the Arab banks doing much lending to the LDCs. According to these spokesmen, the Arab banks will roll their funds around to jurisdictions where it is convenient--i.e., where they can get around the religious views on interest, converting ordinary earnings into capital gains. One banker characterized these institutions as "glorified bagmen!" They say it is unlikely they are going to come into the game on any significant scale especially if they sense there is retrenchment on the part of the old line eurobank players.

Outfits such as ABC will do some lending to high-income LDC's, but in general their posture will be conservative and apolitical. One banker suggested that the "development game" is over and that we won't have recycling without stringent conditions in the future.

On the subject of likely developments in Poland down the road two or three years, two of the four bankers hadn't really thought about it, nor did they have any ideas. I got the impression these bankers would be happy to begin concentrating their skills and talents on other countries where prospects perhaps are a little brighter! The other two bankers present a rather sober assessment of prospects--both of these bankers speak Polish and could be characterized as "East European hands." They see in Poland a massive process of political restructuring occurring which is already underway. The party is bankrupt and the purging of the bureaucracy will continue. This process will take a few years. The Solidarity movement in their view will be cleaned out. Yes, the name may be restored to appease the outside world as well as Poles, but the original creators of Solidarity will be out of the picture and new people will be put in charge of any such movement so that the union can never come back in anything like the form which has proven

troublesome. They see the security forces as being very busy in Poland. These folks will clean out all threats--even the Church, although this institution obviously is a sensitive area and will take some time. The army will move out, curfews lifted, etc. This doesn't mean anything. The bankers suggested that it was a big joke discussing the military in the press and on TV during the recent uprisings. The military played a very minor role with most activity being directed and implemented by the security forces. They see the situation getting worse with more Soviet involvement before it gets better. In effect, they see a police state being reimposed in a much more rigid way.

The Polish people will go back to work and the economic condition will gradually improve. It will be a long time in the view of these bankers, however, before Poland can begin servicing debt. The burden of present debt will require at least until the end of the 1980's to service.

All four bankers don't see banks returning voluntarily into Poland for at least five to ten years. The German bankers are terrified that they have already gotten in too deeply. The Americans feel that the Poles handled the debt negotiations very poorly. When questioned about this, the bankers suggest that the Polish negotiators have treated all

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holders of debt alike--that is to say, all banks are being treated the same, the governments the same, and so forth. According to the bankers, what the Poles should do is to look at the nature of the specific indebtedness rather than the sources of financing. There needs to be a differentiation made between bond holders, project lenders, trade financiers, and so forth, in order for the banks to want to play ball with the Polish borrowers. Otherwise, the creditors forfeit all their rights. They don't see anyone willing to do straight financial lending to Poland unless Poland reverses what all four regard as a strategic error in debt servicing attitude.