

Commercial Banks, Default Insurance and IMF Reforms

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The authors argue in favour of establishing a system whereby the IMF provides insurance to the private lenders, protecting them from the risk of default by the sovereign debtor. Though the authors claim that this system effectively helps address the problem of moral hazard on part of the private lenders, I suggest that the authors should give clearer explanation what are the incentives/benefits on part of the private banks and the IMF to participate in such scheme and how such scheme improves upon the status quo. Moreover, there are few observations to be highlighted:

1. I suggest the author to mention problem of debtor moral hazard resulted from insurance scheme, especially if debtor purchases insurance from IMF instead of the private lenders (as argued at the beginning of section 4 by Soros (1998)).
2. What is the implication of this type of policy recommendation in the world with a transition to Collective Action Clauses (CACs)?
3. More extensive literature review would be helpful.
4. It would be nice if the authors could explain why option pricing is appropriate in calculating the insurance premium and add the justification why European put option was chosen instead of American option.
5. Before rescuing the private lenders in the even that sovereign debtor chose to default, does the IMF investigate the nature and cause of the crisis first, whether it is due to bad luck, bad policy or both? And whether it is solvency or liquidity problem?
6. In becoming member of the IMF, are there any key eligibility criteria? How to choose which bank to join?
7. Clearer explanation for the division of duties between domestic central bank and the IMF.
8. Given that in the event of crisis, it is not credible for the IMF to say “no” to non-members, how would this affect the incentive of private lenders in purchasing insurance from the IMF and becoming member of the IMF?