REPORT OF EXPERT GROUP MEETING
ON SOVEREIGN DEBT RESTRUCTURING:
THE ROAD AHEAD

Organised by the Financing for Development Office, DESA and the Bank of England, London, Friday 25 April, 2014

Overview

On Friday 25 April, 2014, the Bank of England hosted the fourth in a series of United Nations-initiated[1] expert group meetings on sovereign debt restructuring. The aim of these meetings is to explore concrete, practical steps to improve the current framework for sovereign debt restructurings. Participants at this meeting included leading experts from law, academia, international institutions, private-sector creditor groups, other market participants, civil society and policy makers. This report offers a summary of discussion and is not intended as a verbatim record of the contributions made by each participant.[2] The meeting was conducted under Chatham House rule. Annex I outlines the agenda and Annex II lists the participants.

The Expert Group considered a range of issues, asking, among many other questions, what are the problems with the current voluntary, contract-based framework for sovereign debt restructuring, how do we prioritise them, can the international financial architecture be improved, are contractual solutions achievable and what, statutory reforms are possible and desirable to encourage more timely restructurings and greater clarity on common rules for sovereign debt restructurings?

While opinions were diverse and discussion frank, many participants agreed with the proposition that the current system offered room for improvement.

Pareto improvements are possible

- Once an entity finds itself in debt overhang, it cannot grow out of a hole that deep. In such situations the only alternative is to restructure.
- Since the debtor is on the wrong side of the debt Laffer curve, restructuring is a win-win for both creditors and debtors. There are, in economic terms, Pareto improvements to be made from restructuring early and in sufficient size to get the debtor to the right side of the debt Laffer curve

- ave the architecture to allow countries to leap to the right side of the Laffer curve.

Too little, too late

- Since 1970 there have more than 180 sovereign debt restr great many of these crises were characterized by official i

[1] Financing for Development Office, Department of Economic and Social Affairs, United Nations.
[2] This summary was drafted by Benu Schneider (FfDO) and Mark Joy (Bank of England).

and the restructurings themselves were too little to put the crisis-hit countries on a

Several participants noted that there are inefficiencies that, if eliminated or reduced, would benefit not only borrowing countries but also creditors. In particular it was noted that impediments to countries getting into restructurings, when restructurings are the most efficient option, should be eliminated. Also, while the restructuring process itself once initiated can often be swift, it could still be made more effective.

Some thought that creditor committees, with ex-ante rules owhich are well-defined with a governance and oversight structure would be capable, if given an established role in the restructuring process, of increasing speed, comprehensiveness and scale of participation.

It was also noted by a number of participants that restructurings, once they have been agreed, need to be made to stick. Too many countries have, it was argued, experienced multiple, successive restructurings.

A key focus for discussion was current proposals to reform standard sovereign bond contracts in order to address collective action problems. Collective action clauses (CACs) with *aggregation* were discussed, in particular a proposal to allow for a stronger form of aggregation than that permitted already in euro area aggregated CACs. A number of participants voiced opposition to the assumption that there is a need for stronger aggregation in the form of *single-limb aggregated CACs*, but many participants were in favour, others were agnostic and most were open to thinking further on the issue and to a wider consultation. Participants also discussed amending the *pari passu* clause in a manner that would prevent future misinterpretation, wilful or otherwise, and clarify its intended purpose as representing a promise by the borrower to ensure the bond will always rank equally in right of payment with all of the borrower's other unsubordinated bonds. While some reservations were voiced, many participants offered positive, qualified support to amending the clause. Other contract innovations were discussed, including the introduction of clauses in bond contracts when “standstills” in meeting debt payments can be effected when conditions made it necessary to accord a country “breathing space.” A number of participants voiced support for the idea of sovereign CoCos (as put forward recently in a joint paper by the Bank of England and Bank of Canada) as a means of strengthening market discipline and stemming liquidity crises.

relative to the contemporaneous state of indebtedness. This, it was suggested, could be aided by having a better picture of the debt structure and more information on the holders of the debt. It makes a big difference, it was said, if a sovereign borrower's debt is held by purely banks or pension funds, and this aspect is not captured by the IMF's debt sustainability analysis tool. The IMF tool is excellent for granularity, it was argued, but in some respects, such as debt structure, offers too much granularity (over 200 parameters). It was recommended that the tool should include scope to run scenarios with broad, summary parameters (such as the proportion of debt held domestically versus overseas), as opposed to individual, granular parameters.

negotiations may have been relevant once, it was argued, but today, the increased presence of creditor holdouts means that the IMF is far less likely to accept creditor accusations that the borrower is not negotiating in good faith. It was suggested, furthermore, that good faith negotiations are difficult to measure

new clause's market acceptability and legal enforceability. Response to the ICMA's proposed clause has so far been favourable. It was argued that the proposal to amend the *pari passu* clause was a promising development, but too much radicalism should be avoided: trying to limit the remedy may be the most effective approach, it was said.

Collective action clauses (CACs) within a single bond issue have existed for more than a

Contractual reform may solve some problems, but not all. Some statutory arrangements were discussed.

A specific proposal was put forward for the euro area: it was argued that an amendment of the Treaty establishing the European Stability Mechanism could allow for the immunization of the assets of a euro zone country receiving an ESM bailout from attachment by creditor holdouts. By making it more difficult for holdouts to enforce court judgments against a debtor country, the objective of the amendment would be to deflate creditor expectations that staying out of an ESM-supported sovereign debt restructuring will lead to a preferential recovery for the holdouts. Other participants agreed that the euro area was more pliable to reform. Creditors in the euro area can be compelled, it was argued, because there can be treaty-based amendments. Meaningful sovereignty has been surrendered in the euro area. Statutory solutions may work. A Sovereign Debt Restructuring Mechanism for the euro area is, argued one participant, a workable possibility.

Statutory options from past expert group meetings were also outlined.

The system could keep best of the contractual approach and combine it with some kind of statutory arrangement that is created in the shadow of the court house. This is similar to WTO dispute resolution mechanism, where there can be three stages to ensure orderly debt restructuring:

1. Stage 1 would be the status quo, purely voluntary, but time bound. If a solution is not found within this time, then we can go to the next stage
2. The next stage, again time bound. A panel of experts can guide the negotiations. If that does not work then we can go on to the next stage
3. The final stage would have a panel of judges that pass judgement which is binding on all. No possibility of holdouts.

Some participants pointed out that the WTO mechanism model might not be relevant because speed is of the essence of sovereign debt restructuring

Another options is an independent arbitration court or something set up at the IMF. The Brookigns Institution proposed a Sovereign Debt

In terms of future work it was pointed out that regulatory, tax and accounting regimes interact to create incentives or disincentives, as the case may be, for the timely, orderly restructuring of sovereign debt. There is need for work in this area.

Moreover, reliable and consistent information on international liabilities is needed to

Annex I

AGENDA

9:30 – 9.45am

Annex II

PARTICIPANTS

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