71st General Assembly Second Committee Meetings

Side Event:

Organised by the United Nations Conference for Trade and Development (UNCTAD)

Date: Wednesday, 26 October 2016, 10 am – 1 pm,
Place: Conference Room 2, Conference Building, United Nations Headquarters, New York

Context and Background

So long as private debt defaults do not affect the wider economy, managing them essentially involves the application of commercial law in the jurisdiction where the debt was issued. Sovereign external debt poses a different set of challenges. Foremost amongst these is the consideration that the macroeconomic management of sovereign debt has far-reaching social, economic and political impacts on whole populations as well as through the provision of public goods. In addition, sovereigns are both more, as well as less, vulnerable than private debtors: One the one hand, sovereigns unable to service their debt cannot seek the protection of bankruptcy laws to restructure or delay payments, as private debtors can do. On the other hand, creditors cannot easily seize non-commercial public assets in payment for a defaulted sovereign debt. As a consequence, sovereign debt issues have historically been addressed through direct negotiations between sovereign debtors and their creditors.

The contemporary system of sovereign debt restructuring is highly fragmented and based on a number of ad hoc arrangements. This fragmentation has given rise to numerous inefficiencies. First, sovereign external debt problems tend to be addressed "too late" with "too little". Debtor governments have been reluctant to recognize solvency problems for fear of triggering capital outflows, financial distress and economic crisis, while private creditors have an obvious interest in delaying explicit recognition of a solvency crisis, likely to entail haircuts. Second, the current system predominantly places the burden of adjustment on the debtor economies, through austerity policies and structural reforms, with a strong recessionary bias. And finally, the fast growing promotion of creditor rights as well as the rapid rise of bond financing in external debt markets has rendered sovereign debt restructuring enormously complex. In addition to the involvement of often thousands of bondholders with diverging interests as well as a range of jurisdictions, this has also facilitated the emergence of highly speculative funds, run by non-cooperative or holdout bondholders, including the so-called vulture funds.

Uncooperative or holdout creditors in sovereign debt workouts are thus mostly financial institutions or funds trading sovereign debt in secondary markets. While this does not apply to all uncooperative creditors, vulture funds specifically are usually hedge funds, that is, a limited liability fund pooling investor capital in securities and other financial instruments with no or little regulation for caps on leverage. The reverse does not, of course, hold: Not all hedge funds are vulture funds.

According to the UK Treasury, vulture funds [...] buy up defaulted debts at very low prices when a country is in economic distress and aggressively litigate to recoup the debt's full value".[1] **Similarly,**

In addition, some governments have proposed or adopted national legislation to target vulture fund activities. Thus, in July 2015, the Belgian parliament overwhelmingly adopted a bill “to combat vulture fund activities”. At the heart of this new law is the introduction of a ceiling for the amount the so-called vulture funds can reclaim from government bonds bought at highly discounted prices in secondary bond markets from economies close to default. The law allows Belgian judges to stop vulture funds from claiming repayment above the discounted market price it paid for government bonds, for example at original face value. The only other national initiative relating to vulture funds to have passed the test of a parliamentary vote is the United Kingdom Debt Relief Act (Developing Countries) of 2010, which prevents vulture funds from gaining massive profits from debt restructuring in developing economies. Other national legislative initiatives to this effect, and with a particular focus on developing-country debt, have been proposed in several European countries and in the United States, but so far they have not been enacted.

At the international level work has been done to identify and define soft-law principles to guide sovereign debt restructurings. In particular, in September 2015 the UN General Assembly adopted resolution A/RES/69/319 on Basic Principles on Sovereign Debt Restructuring Processes. The resolution stresses "the importance of a clear set of principles for the management and resolution of financial crises that take into account the obligation of sovereign debtors and their creditors to act in good faith and with cooperative spirit to reach a consensual rearrangement of the debt of sovereign States".

Objectives

This side-event of the Second Committee will analyse, discuss and weigh the pros and cons of different approaches to addressing the drawbacks of creditor co-ordination failure and the role of holdout creditors in sovereign debt restructurings. Particular attention will be paid to national legislation and any implications for both contractual as well as non-contractual (international) approaches to the regulation of hold-out creditor activities.

The specific objectives of the side event are as follows:

a. Contribute ideas and expert knowledge to inform the Committee's deliberations on specific challenges

Suggested questions for discussion:

1. What, so far, can we reliably say about the social and economic impacts of creditor co-ordination failure and of vulture fund activities?
2. How applicable are efficiency arguments for and against ‘vulture’ investment strategies in markets for corporate re-structuring to those for sovereign debt?
3. What role can or should the international principle of national sovereignty play in weighing the pros and cons of vulture fund activities in sovereign debt markets?
4. How effective, so far, is national legislation, relative to contractual approaches and international regulatory frameworks?
5. How, and to what extent, can and must such regulation also safeguard the principle of the equal treatment of creditors?