EXPERT GROUP MEETING ON SOVEREIGN DEBT RESTRUCTURING[1]

United Nations, New York, 18 May 2012

Informal summary[2]

The Financing for Development Office (FfDO) of the United Nations Department of Economic and Social Affairs (UNDESA) and The Centre for International Governance Innovation (CIGI) organized an Expert Group Meeting on Sovereign Debt Restructuring on 18 May 2012. Participants included leading experts representing international institutions, academia, private sector creditor groups and other market participants, the G24 Secretariat, civil society and policy makers, as well as the facilitator and negotiator of the UN Second Committee debt resolution.[3] The meeting was convened to explore concrete, practical steps to improve the framework for the timely and orderly restructuring of sovereign debt.

The Expert Group considered a range of issues, including *ex ante* incentive structures and institutional arrangements that facilitate or impede restructuring, recent developments with respect to voluntary debt exchanges, the outlook with respect to continued reliance on such mechanisms and possible enhancements and alternatives to the status quo. Participants considered both the possible need for statutory mechanisms to facilitate timely restructuring and provide greater clarity on the rules by which sovereign debt restructuring will occur, and options under the voluntary contractual approach. A panel discussed the priority of and prospects for reforms to improve the architecture for debt restructuring. The meeting featured a frank discussion of possible measures to enhance the effectiveness of the debt restructuring process and, as a result, to improve the efficiency of global capital markets by reducing losses faced by creditors, sovereign borrowers and others adversely affected by the uncertainty surrounding potentially disruptive debt scenarios.

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[1]The FfDO has been organizing multi-stakeholder consultations on external debt under its mandate. General Assembly resolution 60/188 recognized the work of the FfDO within the General Assembly's mandate to organize multi-stakeholder consultations, panel discussions and other activities and called on the FfDO to continue its work in this area. In resolution 2009/30 (July 31, 2009), the United Nations Economic and Social Council reiterated its mandate to continue to foster mutual understanding among members of all relevant stakeholder groups jFinancial and Economic Crisis and Its Impact on Development (A/RES/63/303) and the General Assembly Resolution on External Debt Sustainability and Development (A/RES/66/189). The project is managed by Ms. Benu Schneider, with financial support from the Government of Norway. This was the fifth meeting in the series. The reports of earlier meetings are posted at www.un.org/esa/ffd.

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Meeting Highlights

1. **The discussion reflected greater readiness to discuss alternatives to the status quo**. While the recent "successes" of voluntary approaches were noted, there was broad discontent with where we are today. In effect, the environment is uncertain, unpredictable, fragmented, ad hoc and non-transparent. This contrasts, it was argued, with domestic bankruptcy frameworks that provide some clarity with respect to the process for resolving debt problems, which thereby facilitates timely workouts. The delay in resolving problems is extremely costly for all involved; it represents a dead weight loss to both creditors and countries. As illustrated by the continuing debt problems in Europe, delays in resolving debt problems can pose a significant threat to international financial stability. Furthermore, litigation is not a solution, it was agreed, as outcomes cannot be enforced and, more importantly, because a comprehensive resolution is much preferable to thousands of individual lawsuits that are costly and cause delays. An overall resolution is in the joint interest of the debtor and (most) creditors.

2. **Five concrete proposals were put forward:** (i)Voluntary efforts at setting up structures for creditor committees, including permanent committees to speed creditor coordination; (ii)

official support can lead to both debtor and creditor moral hazard, as debtors defer needed adjustments hoping for an improvement in economic conditions and lenders do not correctly price

9. **Regulation, accounting and tax rules:** Expert Group participants agreed that there is important work to be done in understanding how regulatory, tax and accounting regimes interact to create incentives or disincentives, as the case may be, for the timely, orderly restructuring of sovereign debt. Ten key issues were identified for further consideration (see Annex 3).

10. **Information on debt stocks and flows:** There was broad agreement that reliable and consistent information on international liabilities is needed to facilitate timely debt restructurings. Participants supported efforts to establish an international registry of debt, reported by creditors and reconciled with debtors.

11. **Assessing debt sustainability:** Several participants expressed discontent with the current practice of assessing debt sustainability and argued in favour of greater transparency and a greater voice for private sector creditors in the determination of debt sustainability, including discussion of potential assets subject to privatization, as well as the size of prospective haircuts. Other participants noted that debt sustainability entails considerations of "willingness" to repay, in addition to the borrower's "ability" or capacity to repay. The IMF plays a unique role in assisting its members to strike a judicious balance between financing and adjustment, but as noted earlier, it runs the risk of being less effective in this role due to the absence of a framework for timely and orderly debt restructuring, and its role could be enhanced by improvements to the debt restructuring framework.

12. **Standstills:** Standstills, or suspensions of payments, can provide a "breathing space" in which the borrower can identify and implement a sound policy framework that promotes sustainable adjustment, preserves asset values and supports growth to the mutual benefit of debtors and creditors. In practice, given the absence of credible means to enforce judgments and the application of sovereign immunity, sovereigns can impose de facto standstills through the exercise of force majeure. The fundamental issue is whether a more formal process for the declaration of a standstill, in conjunction with lending into arrears by the IMF, is required. Such a process would provide a stay on all litigation by individual creditors, preventing a panicked rush to the exits that triggers a rollover crisis and a race to the courthouse. Two options were discussed:

    Voluntary approach: The first proposal was to include standstills in bond contracts to set out the contractual terms for non-payment of interest and suspension of payments. Contractual terms in sovereign bonds typically have a grace period of three to13 days, which is intended to facilitate the resolution of any technical difficulties in making payments, and certainly not to facilitate a restructuring.

    In that regard, principles for a standstill could be developed and included in the Institute of International Finance CAC guidelines. But this approach is not without its own complications. Although consent for new financing could be obtained through trustee relationships or collective action management, trustees don't like discretion, and thus clearer rules are needed. Moreover, timing issues would also have to be overcome, since notice of 21 days is required to call a meeting of creditor committees.

    Some of the advantages of a standstill are that it prioritizes financial stability, prevents cross-border default and acceleration, and brings creditors together. However, it remains an open question whether a fixed time limit on a standstill would help or hurt a sovereign attempt to restructure. There are also accounting, impairment, credit rating and credit-default-swap

trigger issues that would have to be addressed. Accordingly, more work is needed to understand the likely reaction to such change by creditors and anticipate if it would, in any way, impose unwelcome policy restrictions on sovereigns.

Statutory approach: Instead of voluntarily including provisions for standstills in debt contracts, a statutory approach could provide for a comprehensive standstill process under international law or through the IMF's Articles of Agreement. Effecting statutory standstills through the IMF's Articles and amendments to them would be the easiest approach. The IMF's capacity under Article VIII, 2(b) to temporarily approve restrictions on current payments (that is to say, interest payments) could result in partial stays on creditor actions on arrears. For other arrears relating to capital payments (for example, non-payment of bullet payments of principal), an amendment of the IMF Articles of Agreement would be required to achieve symmetry between the treatment of arrears arising from capital and those from current payments. But some participants noted that this approach may further lead to a conflict of interest in the IMF's role of arbiter and creditor.

13.

As the power of neutrality is important, the Sovereign Debt Forum should be a neutral organization with broad participation. It could have permanent, neutral staff seconded from debtors, private creditors and multilateral institutions, and it should aim to design a collective, consistent process to enhance sovereign debt as an asset class. This process would provide a standard template that would remove the guesswork from initiating an open dialogue on a particular restructuring, but it would be non-statutory and flexibly applied on a case-by-case basis.

This should result in the creation of a sovereign debt facilitation, which would equally represent the concerns of debtors, public creditors, private creditors and multilateral institutions. The forum would be structured to permit a free exchange of ideas with strict confidentiality. Its work would be supported by the compilation of a permanent debt registry that would reduce information gaps. The forum would also provide a platform for a frank exchange between creditors and debtors on the macro program and the extent of adjustment feasible and necessary to achieve sustainability and a resumption of growth in the debtor country.

There was considerable interest from all participants on the Sovereign Debt Forum and broad encouragement to discuss this proposal further.

ANNEX 1

Agenda

Expert Group Meeting on Sovereign Debt Restructuring

Financing for Development Office (FfDO
United Nations Department of Economic and Social Affairs (UNDESA)
The Centre for International Governance Innovation (CIGI)
United Nations, New York, NY, May 18, 2012
Meeting Room 6, North Lawn Building

8:45–9:15	**Registration**	
9:15–9:30	**Welcome and Introduction**	
	Jomo K. Sundaram Alex Trepelkov	Assistant Secretary General, Department for Economic and Social Affairs, United Nations Director, Financing for Development Office, Department for Economic and Social Affairs, United Nations
9:30–9:45	**Scene Setting**	
	Benu Schneider James Haley	Chief Development Finance and External Debt Unit, FfDO-UNDESA Director, Global Economy Program, CIGI
9:45–11:15	**Ex Ante Financial Architecture for Debt Restructuring**	
	• Andrew Powell: The role of the official sector	Principal Advisor in the Research Department, Inter-American Development Bank
	• Hans Humes: Creditor committees and voluntary codes	President and Chief Investment Officer, Grey Lock Capital Management LLC, New York
	• Whitney Debevoise: The impact of regulation and accounting on incentives for restructuring	Senior Partner at Arnold & Porter LLP
11:15–11:30	**Coffee Break**	

11:30–1:00	**The Bargaining Environment I: Voluntary Approaches to Sovereign Debt Restructuring**	
	• Anna Gelpern: The evolution and limits of voluntary approaches	Professor of Law, American University, Washington College of Law Visiting Fellow, Peterson Institute for International Economics
	• Robert Gray: Expanding contractual technology (aggregation clauses, CACs)	Chairman, Regulatory Policy Committee,International Capital Market Association (ICMA)
	• James Kerr: Impasse in litigation	Counsel, Litigation Department, Davis Polk, New York
	• Deborah Nache-Zandstra: Contractuallydefined “breathing spaces”	Partner, Sovereign Debt Restructuring Group,Clifford Chance, London
1:00–2:00	**Lunch**	

2:00–3:30 **The Bargaining Environment II: Institutional Approaches to SnT0 1 Tf0.002.96Approaches to SnT0 2 0n391.**

ANNEX 2

List of Participants

Expert Group Meeting on Sovereign Debt Restructuring

United Nations, North Lawn Building, Meeting Room 6, May 18, 2012

• Katerina Alexandraki	Lazard Asset Management Emerging Markets Economist/Strategist
• Agata Antkiewicz	The Centre for International Governance Innovation (CIGI) Senior Researcher, Global Economy Program
• Domingo Cavallo	DFC Associates, LLC, Chairman and CEO Jackson Institute for Global Affairs, Yale University Senior Fellow and Lecturer
• Anisuzzaman Chowdhury	Department of Economic and Social Affairs, United Nations Senior Economic Affairs Officer
• Jean-Marc Coicaud	Rutgers University Professor of Law and Global Affairs and Director of the Division of Global Affairs
• Carmen Corrales	Cleary Gottlieb Steen & Hamilton LLP Partner
• Whitney Debevoise	Arnold & Porter LLP Senior Partner
• Merete Dyrud	Permanent Mission of Norway to the United Nations Counselor
• Eric Fine	Van Eck Global Portfolio Manager
• Anna Gelpern	American University, Washington College of Law Professor of Law and Visiting Fellow Peterson Institutefor International Economics
• Richard Gitlin	Richard Gitlin and Company LLC President
• Robert Gray	International Capital Market Association (ICMA) Chairman, Regulatory Policy Committee

• Friederike Pohlenz	Swiss Ministry of Finance Deputy Head of the International Financial Institutions Section
• Andrew Powell	Inter-American Development Bank Principal Advisor in the Research Department

ANNEX 3

Accounting, Tax and Regulatory Issues Requiring Further Study

The following ten issues were identified for further study:

disclosure guidelines: consideration should be given to the potential implications of differences in disclosure guidelines that could have significant effects given the heterogeneity of the bondholder community;

treatment of non-accrual loans, particularly in creating an incentive for timely restructurings;

tax and regulatory treatment of loss reserves (and recovery of reserves);

ex post tax treatment of a debt reduction offer;

tax treatment of interest capitalization;

provisioning requirements of credit enhancements received in a restructuring;

impact of Basel banking regulations, which envision sovereign debt as low risk and therefore not