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Multilateral Policy Responses II: Sovereign Debt Restructurings – Practical Ways Forward

by

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Sovereign debt restructurings – practical ways forward

**The European Commission's study on
countering the harmful effects of holdout
behavior on developing countries**

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Reasons for the study

- The European Parliament report in March 2018 on ‘enhancing developing countries debt sustainability’
- The issue is mentioned both in the AAAA and the G20 Operational Guidelines for Sustainable Financing
- Increasing debt vulnerabilities in developing countries
- It was not a feasibility study, only to explore options and encourage stakeholder consultation

Recent history that led to the study

- *IMF SDRM in 2002*
- *UN Process and Resolution in 2015*
- *We have a market-based approach, with obvious weaknesses – while risks are rising*
- *EU member states VF laws*
- *Greek and Argentinian cases most recently*

How to define vulture funds?

- It is difficult to characterize them having regard only to their legal nature, shareholders, country of residence or other « objective » criteria (even if these criteria might help)
- All funds buying distressed sovereign debt are not VF. Some global investment funds are adopting a holdout behaviour in certain cases.
- The study proposed to address holdout behaviour in general, instead of trying to define VFs; Holdout behaviour is harmful in many restructurings, causing protracted debt crisis and inter-creditor equity issues
- Need to distinguish between harmful and legitimate holdout behaviour

Available instruments to counter Vulture Funds

- **CACs:**
 - ✓ Blocking minority? Especially in emerging and developing countries?
 - ✓ Legacy debt (bonds)? Do we have the time?
 - ✓ New bonds issuances without enhanced CACs?
 - ✓ Other forms of indebtedness (loans, commodities trading, derivatives, domestic debt...)?
- **National laws (UK, Belgium, France a.o.):**
 - ✓ Limited scope of application (domestic jurisdiction)
 - ✓ Does not address holdout behaviour in general

Possible ways forward with the contractual approach

- Standardize enhanced CACs and pari passu clauses
- Integrate CACs into domestic / regional sovereign bonds (EU single-limb CAC as a model) or SOE bonds?
- Use of Trustees
- Replicate the work done in bond contracts for loans:
 - Loans are still very important in low-income countries
 - They are not as transparent as bonds
- Focus on certain clauses in loan contracts:
 - Assignment / Transfer provisions (also for bonds)
 - Non-disclosure clauses to increase transparency
 - Lowering voting rights threshold / sharing clauses
 - Refine default events / Cross-default clauses
 - Pre-default, automatic payment deferrals (or interest rate reduction) in case of natural disaster, climate event

Regulatory solution – EU Level

- Only eligible sovereign debts can be litigated in an EU Court. Debt is eligible if:
 - it has been contracted by the debtor according to its own constitutional rules;
 - the conclusion of the debt agreement did not give rise to any unlawful manoeuvre from the creditor or his representatives or any intermediary acting on behalf of the creditor or his representatives, to induce the debtor to contract the debt towards that creditor or his representatives.
- Moratorium on litigation until a time-limited debt restructuring negotiation ends (engagement in the process in good faith)
- Holdout's rights will be restricted to 1) the agreed terms by majority of creditors, 2) purchase price in case of no agreement or 3) calculated price based on pre-defined formula
- Immunising payment and clearing systems from attachment by the creditors

Other considerations

- Countries should avoid selling bilateral distressed debt on the secondary market and keep the loans in their own portfolio
- Centralisation of debt issuance and management: vulture funds prey on “split issuances” – small amount, lower capacity to negotiate terms, insufficient central overview
- Increasing use of non-transparent collaterals – create problems for restructuring, may violate negative pledge clauses
- How to move forward with the Paris Club?
- IMF’s role in debt restructuring

Thank you for your attention!