



UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

**UNCTAD**

# **PROJECT ON PROMOTING RESPONSIBLE SOVEREIGN LENDING AND BORROWING AND DEBT WORKOUT MECHANISM**

**PROGRESS REPORT**

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## THE PROJECT

Being the focal point of the United Nations system for debt issues, UNCTAD is uniquely positioned to shape opinions and promote important debt-related issues at the international level through its analytical work, consensus building and technical assistance projects. The project on Promoting Responsible Sovereign Lending and Borrowing is a case in point with the financial and political support from the Government of Norway. This Project was started in 2009 with the active participation of the IMF, the World Bank, regional development banks, other multilateral and regional institutions, experts from the private sector, NGOs and academia.

Currently, the Project is prominently positioned on the international agenda and is being widely acknowledged. The UN General Assembly resolutions of the past few years have indicated clear support to the UNCTAD initiative by stressing the importance of promoting responsible sovereign lending and borrowing. The term "responsible sovereign lending and borrowing" is now being recognized and frequently used beyond the UN by various publications, governments, academic circles, among NGOs and in the press. In April 2012, the mandate negotiated at UNCTAD XIII reflected this widespread support.

Contemporaneously with the dissemination of the Principles on Responsible Lending and Borrowing released for endorsement in April 2012, UNCTAD has been alerting policy makers on the fact that while responsible and prudent behaviors in debt contracting are necessary to reduce the prevalence of debt crises, they are insufficient to stop them. A debt workout mechanism, devised in a transparent and inclusive manner, is thus needed to deal with these debt crises.

With more than 40 years' analytical work experience in the area of debt restructuring mechanisms, UNCTAD has been among the first to reinvigorate the international discourse on the issue since the onset of the global financial crisis. The further mobilization for the Principles' endorsement and implementation side by side with the promotion of a debt work out mechanism complements each other well. UNCTAD would endeavor to achieve these goals not only through intensifying the international debate at the level of the United Nations General Assembly and other international fora, but also continuing with its country and regional consultative process.

## RECENT EVENTS AND IMPLICATIONS FOR THE PROJECT

In 2014, the field of sovereign debt has been at the center of events with potential implications on the future of the Project on Responsible Sovereign Lending and Borrowing.

The NML v. Argentina litigation has come to a close favoring the claimants led by a group of hedge funds seeking the repayment of their investment in full following the 2005 Argentine sovereign debt

restructuring. The United States Supreme Court issued a ruling on 16 June 2014 declining to hear Argentina's appeal against a lower New York court decision that had ordered it to pay suing hedge funds \$1.33 billion for holdout bonds. This was followed shortly by another decision by the Supreme Court to order the relevant financial institutions of the United States of America to turn over information to these hedge funds about assets that Argentina holds worldwide, including accounts held by entities of the Government of Argentina and by individual officials. This ruling, based on a peculiar interpretation of the pari passu clause, eventually led to Argentina's technical default in September 2014. This ruling also has wide implications in terms of sovereign immunity and the structure of incentives for creditors to holdout in future restructuring processes.

In the aftermath of the NY Supreme Court decision, on 9 October 2014 a UN General Assembly Resolution (A/68/L.57) requesting the establishment of a multilateral framework for sovereign debt restructuring processes was voted and generated 124 votes in favor, 11 against and 41 abstentions.

These two events bring about the following considerations:

- Wide international consensus has been found on the fact that hedge funds' activities with respect to sovereigns in default are highly disruptive in restructuring processes and should be regulated. This consensus includes creditors and bondholders' associations such as the International Capital Market Association (ICMA) which, in light of the outcome of the US ruling, released a revised version of their contractual approach to sovereign bond restructuring<sup>1</sup>. The IMF endorsed this approach in their latest working paper (October 2014) on 'Strengthening the contractual framework to address collective action problems in sovereign debt restructuring'.

- the Group of 77, by tabling the GA resolution (A/68/L.57) and negotiating its modalities, is sending the signal that some basic rules should be observed at the international level with respect to sovereign debt restructurings. At the same time, the group of developed countries is showing their reluctance to embark on a path that would be leading to a multilateral convention on sovereign debt restructuring.

With such consideration in mind, while on the whole UNCTAD's position on the desirability of a sovereign debt workout is clear, we continue to provide a forum for building consensus and bridging the divide among diverging views at the international level on sovereign debt matters with a view to reducing the prevalence of debt crises and facilitating debt restructuring processes in a prompt, fair and efficient way. Its current work on principles for a debt workout mechanism and a Roadmap constitute an attempt to take into account the views and concerns of all stakeholders involved in debt restructuring processes and go forward with an informal normative endeavor at the international level.

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<sup>1</sup> ICMA 'Standard Aggregated Collective Action Clauses (CACs) for the terms and conditions of sovereign notes', August 2014

## THE EXPERT GROUPS

UNCTAD coordinates and is the secretariat to two expert groups that act as a source of technical and policy analysis. The first group (hereafter the PRSLB Expert Group) is the one constituted in 2010 for the purpose of designing the Principles on Responsible Sovereign Lending and Borrowing. The PRSLB Expert Group is currently being consulted on the Guidelines on Responsible Sovereign Lending and Borrowing. The second group (hereinafter the DWM Working Group) was formed in March 2013 for the purpose of working on the Debt Workout Mechanism. These Groups initiate and enrich the discussion on factors that would promote responsible sovereign lending and borrowing and a debt restructuring mechanism. (Please see the annex with the list of members and observers in both groups).

Both the DWM Working Group and the PRSLB Expert Group are composed of renowned scholars and experts on debt issues who act in their professional capacity. These groups represent no national or outside interests other than the fostering of responsible sovereign lending and borrowing and a timely, fair and transparent debt restructuring mechanism. Each member is selected on the basis of its representativeness of a stakeholder group, its professional experience and seniority in the organization it represents. UNCTAD's role is to ensure the diversity of participation and opinions in these groups as well as to maintain a balance in interest representation. These Groups address the legal, the economic, and the social dimensions of responsible sovereign lending and borrowing, including with respect to sovereign debt restructuring.

## THE ADVISORY GROUP

The Group of Advisory Countries is composed of government representatives. The group itself has no fixed individual "membership". All interested member governments of the UN are encouraged to send delegates to its meetings or make sure they are duly represented. This group represents national, as well as regional, linguistic and other interests. The group advises the work of the Expert Groups by providing views, concerns and the sharing of practical experience further to the release of the draft documents that they prepare. Since August 2014, the group of Advisory countries has been asked to review the Guidelines on Responsible Sovereign Lending and Borrowing. All comments may be sent at [debt@unctad.org](mailto:debt@unctad.org).

# THE ACTIVITIES

## 1. Activities related to the Principles and the Guidelines on Responsible Sovereign Lending and Borrowing

On 31 October 2014, Mrs. Yuefen Li, the former manager of the project retired. Until the appointment of her successor, the project is under the general leadership of Mr. Dusan Zivkovic.

### *1.1. Promoting countries and institutional endorsements*

- Achievements have been made to obtain political support and acknowledgements from various important multilateral institutions and fora for the Principles. In addition to getting, once again, the endorsement in the debt resolution of the 68 session of UN General Assembly (A/RES/68/202), UNCTAD attended the G20 meeting on sustainable financing held on 8 April 2014, during which the sustainability of sovereign debt was discussed. G20 Member States acknowledged the importance of the Principle.
- Our participation in various other international conferences has always involved the discussion of the Principles. During the Intergovernmental Group of Twenty Four (G24) deputy and ministerial meetings, which took place on 9/10 April 2014 in Washington DC during the 2014 IMF-World Bank Spring Meeting, participants emphasized the necessity for countries to endorse the Principles in order to intensify the momentum towards more responsible practices in contracting sovereign debt. The G24 Director subsequently asked to sign a MOU with UNCTAD to strengthen further cooperation with UNCTAD in areas of macroeconomics and debt.
- UNCTAD also participated in the - G24 Annual consultative meeting, held in Luxor Egypt- on 10-11 March 2014. The Principles were further elaborated at the meeting and their importance was discussed.
- UNCTAD representatives have presented and discussed the Principles and Guidelines in a variety of international fora, such as the 5<sup>th</sup> Debt Management Stakeholders Facility Forum, on "Debt Management in Developing Countries: New Frontiers and Ongoing Challenges" in Brussels; - INTOSAI Development Initiative meetings respectively held in Kuala Lumpur, 20-22 May 2014 and in Mexico on 10-12 June 2014; the INTOSAI working Group on Debt. During these meetings, UNCTAD actively encouraged audiences to engage further in the political endorsement of the Principles; the MEFMI Regional seminar for parliamentarians on public debt management held in Arusha on 8-11 December 2014;

- On the academic and legal front, on 7 May 2014 - the UNCTAD secretariat gave a presentation at the launch of the UNCTAD -coordinated book on Sovereign Financing and International Law, Fundación para la Investigación sobre el Derecho y la Empresa. FIDE C/ Serrano, 26-4ªdcha-28001 Madrid

## ***1.2. Working towards the implementation of the PRSLB***

- In August 2014, the Draft Guidelines on Responsible Sovereign Lending and Borrowing (the Guidelines) were launched for official consultations and widely circulated UN Member States through its missions. Official comments will be integrated into the version 1 of the Guidelines. These Guidelines are expected to be declined in several versions as the document contains practical examples of sound practices which should be updated on a regular basis.

The Guidelines provide policy makers with tools to gain a deeper understanding of the PRSLB and offer options for implementing sound practices on responsible sovereign lending and borrowing, recognising specific conditions of each country. The Guidelines are not prescriptive and they can be used by UN Member States and other relevant stakeholders independent of the endorsement status of the PRSLB. Following the methodology of the PRSLB's formulation, the Guidelines were developed in accordance with a participatory and inclusive approach. Under the coordination of the UNCTAD Secretariat, a group of experts selected on the basis of their practical and legal experience in the area of sovereign debt began to work on the first draft of the Guidelines, which was presented the UNCTAD Debt Management Conference of November 2013. At this conference feedback on the Guidelines was received from government and International Organisations' representatives, members of the Civil Society, think tanks, academia as well as professionals from the private sector. The Guidelines were subsequently revised to reflect and balance the interests of all stakeholders and submitted for several rounds of expert comments.

- INTOSAI-UNCTAD joint work. UNCTAD actively participated in INTOSAI Development Initiative (IDI) meetings, respectively held in Kuala Lumpur, 20-22 May 2014 and in Mexico on 10-12 June 2014; UNCTAD intervened with a view to disseminate the Guidelines on RSLB and to discuss the technical aspects of incorporating the UNCTAD Principles into the international standards used by Auditors General to audit their countries' public debt.

- In February 2014, UNCTAD has received the funding from the UN development Accounts for the purpose fostering the implementation of the PRLSB and its Guidelines. The project has now developed the tools necessary to conduct diagnostic and capacity building workshops in 2015-2016. These tools are embodied by the elaboration of the RSLB Assessment Framework, a survey enabling the identification of gaps in countries institutional and regulatory systems. UNCTAD has also been working on the policy options to be presented to beneficiary countries during the time of the workshop
- On 8-11 December 2014, UNCTAD contributed to MEFMI's Regional seminar for Parliamentarians on Public Debt Management. This event, gathered parliamentarians from the Eastern African Community to raise awareness public on debt management issues. UNCTAD was invited to present the Guidelines on RSLB so as to disseminate them among this audience. Parliamentarians were interested in the Principles and Guidelines and provided positive feedback. They said they would further study both documents in light of their domestic regulations.

## **2. Activities Related to the Debt Workout Mechanism**

### ***2.1. Design of the Debt Workout Mechanism and Roadmap***

- Further to the first two meetings of the Working Group on the debt workout Mechanism and the elaboration of their background papers, the project continued working on the principles and rules of the Debt Workout Mechanism:
- On 19 March 2014 the third meeting of the UNCTAD Working Group on a Debt Workout Mechanism (DWM) was held in Geneva. On this occasion, the Working Group discussed the use as well as legal and economic implications of indicators in showing the potential need for a debt restructuring and guiding restructuring negotiations.

The discussions were based on two background papers that respectively dealt with the legal and economic dimensions of using such indicators. More specifically, the first paper by Michael Riegner introduced different general legal principles on which the design and use of indicators in a DWM may be grounded. These principles comprised efficiency and sustainability, transparency, ownership, and human rights and social protection. The second paper by Jasper Lukkezen and Hugo Romagossa proposed a country-specific indicator framework that signals unsustainable debt paths, which - in combination with an (unexpected) triggering event - may provoke the necessity for debt



restructuring. The Working Group agreed upon the importance of a public discussion on the need for an international body responsible for qualitative assessments as well as on the institutional and operational requirements that would ensure its independence and impartiality. Using early warning indicators produced following UN contribution would further add an international public governance dimension to the private credit ratings that are already at work on global markets.

- On July 7, 2014 the fourth meeting of the UNCTAD Working Group on a Debt Workout Mechanism (DWM) was held in New York to discuss the theoretical framework and implementation impact of the principles of legitimacy and impartiality. Discussions among the members of the Working Group began in response to the presentation of the background paper prepared by Odette Lienau (Cornell Law) on legitimacy and impartiality of a debt workout mechanism. Questions revolved around the choice of elements that would make the Debt Workout Mechanism most legitimate and the trade-offs that such choices would imply (e.g. efficiency vs. impartiality).

The second session introduced practical concerns associated with past and current sovereign debt restructurings. Debates entailed the need to handle and balance the competing interests of the stakeholders participating in such restructurings as well as the importance of conveying the message that legitimacy and impartiality should not be overlooked even in times of urgency. The Working Group agreed that the costs of disregarding these were high although the difficulty to produce tangible estimates of these costs was expressed as a shared concern. The Group also noted the fragmented institutional (and legal) setting in which sovereign debt restructurings happen and reiterated the need to produce a set of legitimate and impartial norms and principles applicable to all decision making processes.

- In accordance with the framing document<sup>2</sup>, the fourth meeting of the Working Group marked the end of the expert discussions on the principles and rules that should underlie the final output of the Project on the Debt Workout Mechanism and the beginning of the drafting process of the Debt Workout Roadmap. Since July 2014, the UNCTAD secretariat has been coordinating a group of initial drafters, who will deliver a first draft of the Debt Workout Roadmap by the end of December 2014. Such draft will then first be reviewed by the Working Group during a fifth meeting in January 2015.

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<sup>2</sup> [http://www.unctad.info/upload/Framing%20Paper%2027%20August\\_finalwithlogo.pdf](http://www.unctad.info/upload/Framing%20Paper%2027%20August_finalwithlogo.pdf)

## ***2.2. Building consensus around the Debt Workout Mechanism***

- 19-20 March 2014 - NYU/UBA/UNCTAD conference on "Sovereign Debt Restructuring: Bridging Economic reality with Law". The joint conference in Buenos Aires focused on sovereign debt restructuring and economic development and represents a major collaboration between NYU Law, UNCTAD, and the University of Buenos Aires Law School. The conference brought together regional stakeholders, including the global faculty teaching in NYU Law's new study abroad program in Buenos Aires, as well as experts from several countries.
- 14 May 2014 - The Permanent Court of Arbitration organized an important expert closed door-meeting with a dozen senior experts in The Hague to discuss new approaches to sovereign debt restructuring. This was meant to sound out views for the forthcoming IMF paper on strengthening the contractual approach as a way forward for future sovereign debt restructurings. Senior IMF officials together with some important lawyers pushed for a future IMF-led market approach debt restructuring system and introduced the forthcoming paper on it. The UNCTAD representative elaborated the insufficiency of such an approach. The meeting did not reach consensus in the end.
- Providing technical expertise in light of the GA resolution (A/68/L.42/Rev.1) on a "multilateral legal framework for sovereign debt restructuring processes". On Tuesday 9 September 2014 in New York, a vote took place on the draft resolution tabled by the G 77 and China. UNCTAD believes in a consensus building approach on this issue. The negotiation process on the modalities of this initiative started in the 69th session of the UN General Assembly in October 2014. During these negotiations, it was suggested that UNCTAD should share its expertise given its status as the focal point for debt matters in the UN system and also in regard to its current work on debt workouts. Irrespective of the final outcome of the GA draft resolution A/C.2/69/L.4 on the modalities for the intergovernmental negotiations and the adoption of a multilateral framework for sovereign debt restructuring processes, UNCTAD will be ready to engage in the dissemination of the Debt Workout Roadmap upon its release at the beginning of 2015.
- GA special event 14 October 2014 on "Lessons learned from debt crises and the ongoing work on sovereign debt restructuring and debt resolution mechanisms" held at UN Headquarters in New York. UNCTAD provided substantive support for the preparation of the Special Joint Meeting of the Second Committee of the General Assembly and the Economic and Social Council on "Lessons learned from debt crises and the ongoing work on sovereign debt restructuring and debt resolution mechanisms" held at UN

Headquarters in New York on 14 October 2014. The special event is prepared in response to the request made by Member States in GA resolution A/68/202.

The meeting was opened by the Chair of the Second Committee, His Excellency Sebastiano Cardi, Permanent Representative of Italy, and the President of the Economic and Social Council, His Excellency Martin Sajdik, Permanent Representative of Austria. Mr. Richard Kozul-Wright, Director of the Division for Globalization and Development Strategies, UNCTAD, moderated the session and discussion on lessons learned from debt crises. Ms. Yuefen Li, Head, Debt and Development Branch, Division for Globalization and Development Strategies, UNCTAD, briefed delegates on UNCTAD's ongoing work in the area of debt workout mechanism. The meeting focused on the following topics: Lessons learned from policy responses to contagion and debt crises and implications of the changing landscape for debt restructuring Ongoing work on sovereign debt restructuring and debt resolution mechanism.

- 2 December 2104, IMF and IDB special event, "Roundtable Discussion on Recent Contractual Reforms to Address Collective Action Problems in Sovereign Debt Restructuring". UNCTAD participated in the debate, stating that although new CACs are a step forward, they fail to address the problem of the existing stock of debt (estimated at USD 900 billion). Furthermore, CACs do not solve the problem of vulture funds suing HIPC, and more work needs to be done on the international mechanism for dealing with defaults, in particular the problem of procrastination. UNCTAD's remarks were appreciated by the IDB and some participating countries (UK and Dominican Republic), but the IMF and US Treasury representatives were reluctant to open a debate on these broader systemic issues.

### **3. Research Activities Related to Responsible Sovereign Financing**

The process of designing the DWM requires solid theoretical and empirical back up. For the purpose of deepening the technical understanding on the DWM's economic, financial, political and legal rationale and implications, UNCTAD has commissioned several research pieces:

- Odette Lienau, a Professor at Cornell University has been commissioned to prepare a background papers on Impartiality and legitimacy in Sovereign debt restructurings.
- Michael Riegner, A research fellow at the Max Planck institute for comparative public law and international law, has been commissioned to prepare a background paper on the legal aspect of indicators on debt.

- Jasper Lukkezen and Hugo Romagosa, Researchers at the Netherlands Bureau for Economic Policy Analysis, have been commissioned to work on the economic aspects of debt indicators

## THE NEXT STAGE

With regards to the Principles, the project has now reached a stage where the focus has switched from developing principles, a stage with much investment in research, to a phase with outreach, consensus building and efforts leading to the implementation of the Principles. Further efforts will be made on to obtain the political endorsement of the PRLSB by Member States. This could be achieved by actively seeking the support of the countries which voted in favor of the GA resolution (A/68/L.57). As for the DWM, the focus of the project is very much anchored in its intellectual design and the provision of a strong rationale for its constitutive elements. Here consultancy fees and expert groups' expenses are prevailing. Activities under intensive preparation include:

- DWM Working Group: Finalizing phase 2 of the elaboration process leading to the Debt Workout Roadmap and dissemination at the UN GA assembly level as well as in other fora.
- Academic publication of the background work carried out in the context of the Project on the principles for a debt workout mechanism.
- Execution phase (involving the beneficiaries) of the Development Account project on the implementation of the PRSLB.
- Continued INTOSAI/IDI assistance with the elaboration of standards on public debt auditing incorporating the PRSLB.
- Continued dissemination of the PRSLB, particularly in the context of the UNCTAD Debt Management Conference to be held in November 2015.