

Creating a Sovereign Debt Restructuring Framework that Works

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Outline

- The objectives of debt restructuring
- The current situation
- The ICMA-IMF response and its limitations
 - Other possible improvements within the contractual approach (SCDSs, GDP indexed bonds, champerty)
- The UN approach

The objectives of debt restructuring

- Bankruptcy regime attempts to balance
 - Ex-ante efficiency (credit assessment, risk-taking)
 - Ex-post efficiency (Efficiency in the restructuring process)
- Excessive penalties would induce delays
- As a result of excess indebtedness, there is a massive waste of resources
- Private outcome is likely to be Pareto inferior
- Market equilibrium characterized by failures (coordination, bargaining, signaling)
- Part of the explanation for existence of domestic bankruptcy laws

The current situation

- But there is no international bankruptcy law
- “Too little, too late” syndrome
 - Since bonds replaced loans, 40 per cent of restructurings ended in re-default or another restructuring within five years (Gelpern 2015)
- And finalization of restructuring could take too long

Recent case: Argentina and the US Courts

- Argentina defaulted in 2001
- Two rounds of restructuring: 2005 and 2010
 - 92.4% of acceptance
 - 1% litigates (debt purchased in default state)
- Griesa's ruling: peculiar interpretation of *pari passu*. Vultures' victory
- Is Argentina an exception?

The current situation

- Remedies on the table:
 - Improvements within the private contractual approach (ICMA-IMF)
 - A multinational framework for sovereign debt restructuring (United Nations)

ICMA's response

- CAC and Pari Passu
 - Improvements over the old terms
 - But not sufficient to solve the current problems
 - Do not solve the problem for the existing debt stock
 - Multiple inter-creditor equity problems
 - Coordination problems
 - Political economy problems

ICMA's response and inter-creditor equity problems

- Problems for determining priority with debt issued in different jurisdictions
- Problems of determining valuations with debt issued in different currencies

ICMA's response and inter-creditor equity problems

- The backgrounds of the negotiations are biased against the “implicit creditors” (workers, pensioners)
- IMF bailout policies favor short-term creditors and hurt long-term creditors, including the implicit creditors

Coordination problems


- With heterogeneous debtors and imperfect information, the market solution leads to a suboptimal signaling equilibrium
- Makes demand for “tough” jurisdictions inelastic

Political economy problems

- It doesn't solve political economy problems both on the debtor's and creditors' side

Possible improvements within the contractual approach

- Full disclosure of SCDS positions



DC Issue 2014073101:	Has a Failure to Pay Credit Event occurred with respect to the Argentine Republic?	
1st Question for vote:	Has a Failure to Pay Credit Event occurred with respect to the Argentine Republic?	
Vote result:	Yes	
Votes:	15 'Yes' votes and 0 'No' votes	
	Bank of America N.A.	Yes
	Barclays Bank plc	Yes
	BlueMountain Capital Management, LLC	Yes
	BNP Paribas	Yes
	Citibank, N.A.	Yes
	Credit Suisse International	Yes
	D.E. Shaw & Co., L.P.	Yes
	Deutsche Bank AG	Yes
	Eaton Vance Management	Yes
	Elliott Management Corporation	Yes
	Goldman Sachs International	Yes
	JPMorgan Chase Bank, N.A.	Yes
	Morgan Stanley & Co. International plc	Yes
	Nomura International plc	Yes
	Pacific Investment Management Co., LLC	Yes

Possible improvements within the contractual approach

- Variants of champerty into contracts
- GDP indexed bonds

Guidelines for a Framework for Sovereign Debt Restructuring

- Must recognize the limitations of the market-based approach
- Must provide the conditions for timely restructurings
- Must be aware of the minimum set of principles over which the parties involved would agree on

UN Principles

- Sovereign's right to design macro policy including right to initiate restructuring
- Good faith
- Transparency
- Impartiality
- Equitable treatment of creditors
- Sovereign Immunity
- Legitimacy
- Sustainability
- (Super)-Majority Restructuring

They have not been respected in recent restructurings, which led to inefficient and inequitable outcomes

Guidelines for a Framework for Sovereign Debt Restructuring: A Possible Framework

- Sovereign initiates the restructuring
- System should incentivize no delays
 - Stays for litigation
 - Lending into arrears
- Stage of possible objections by other parties
- Alternative proposals must justify how they recreate the conditions for sustained growth (instead of just re-creating conditions for repayment in the short-term)
- Proposal should describe the impacts on all stakeholders

Guidelines for a Framework for Sovereign Debt Restructuring: A Possible Framework

- End of the process depends on type of mechanism:
Hard law vs. Soft law
 - *Hard law*: An International Bankruptcy Court would require that countries that adhere to the mechanism sacrifice sovereign immunity
 - And would be associated with complex geopolitical problems
 - *Soft law*: An Oversight Commission (composed by other States that endorse the Multilateral Framework) would act as a supervisor and mediator, but based on the UN principle that no country can sign away its sovereignty
 - It would not have the capacity to rule over the final proposal, but could make statements on its reasonableness
 - Therefore, it would legitimate the outcome of the restructuring process

Conclusions

- Current non-system doesn't achieve the objectives of sovereign debt restructuring
- ICMA-IMF proposal will improve some aspects but will not provide a comprehensive solution
- Space for improving contracts, legal frameworks, and IMF bailout policies
- But with incomplete contracts, the private contractual approach will not suffice (and contracts will always be incomplete)
- Calls for a statutory approach that complements the contractual approach
 - A more efficient restructuring process could lead to lower interest rates
- UN principles are a step in the right direction