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Thessaloniki International Student Model United Nations

2nd Committee of the General Assembly

Topic area B: "Modalities for the intergovernmental negotiations and the adoption of a multilateral legal framework for sovereign debt restructuring processes."

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1. Welcoming Message

Dear participants,

We would like to express our most sincere honor and excitement to serve as Chairs of the 2nd Committee of the General Assembly and in this capacity we shall cordially welcome you to ThessISMUN 2018.

We are convinced that your passion and enthusiasm towards International Relations is indisputably proven by your participation in this simulation. More specifically, your fervor to get involved in the international economic agenda and use your ThessISMUN 2018 as a springboard for your further engagement with the field of International Economic Relations constitutes our duty to deliver. Therefore, we pledge our full devotion on succeeding our goal, which is to facilitate your ThessISMUN and specifically, your 2nd GA Committee experience.

Our agenda this year, contains pertinent and intriguing topics of debate, which are closely connected with each other, as both target the enhancement and facilitation of the UN Development Agenda. Concerning the topic A of our Agenda, we would like to stress out that Trade and Development have become increasingly interrelated within the context of growing economic and financial interdependence among nations in today's globalizing world economy. As a result, international trade and international trade relations can act as a genuine engine of development, as it leads to steady improvement in human conditions by expanding the range of people's choices, increasing cultural interrelation and connecting the different sides of today's multi-faceted economic world.

Regarding now topic B, it is evident that the many consequences of the sovereign debt crisis have made clear that there is a huge gap in the International regulation of sovereign external debt restructuring. This is due to the fact that the international financial system lacks an appropriate and comprehensive multilateral legal framework for restructuring sovereign debt which would enable states to find fair, legal and sustainable solutions that would safeguard their development and economic growth.

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We do hope you find this Study Guide useful. We have strived to provide you with the fundamental background information as well as summarized details and further bibliography, for those wishing to further expand their knowledge in preparation for the conference. Through this, we hope that you will be ready for what will be a sensational and passionate simulation.

Finally, we want to ask all of you to not only carefully read this guide, but also the Rules of Procedure (RoP), as you cannot play the game if don't know the rules.

It goes without saying that we are very much looking forward to meeting each and every one of you in person; it is in these conferences where amazing memories are forged and strong friendships are built. As your chairing team we cannot wait for it to start!

Kind regards,
Board of the 2nd committee of the General Assembly

2. Introduction to the 2nd Committee of the GA

The Second Committee of the General Assembly of the United Nations (also known as the Economic and Financial Committee) is one of the six main committees of the United Nations General Assembly. The membership status in the Second Committee is attributed to all 193 members of the organization[1].

The Second Committee was established in 1945 during the San Francisco conference where "representatives of over eighty per cent of the world's population, people of every race, religion and continent; all determined to set up an organization which would preserve peace and help build a better world"[2] gathered, with an aim in other words, to lay the foundations for the creation of the United Nations. Hence, we can

[1] **Economic and Financial Committee (Second Committee)**
[2] United Nations, 1945: The San Francisco Conference.

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understand the importance of the Economic and Financial Committee since it is an integral part of the UN from the first moments of its existence. The first meeting of the 2nd committee of the GA has held one year later in London.

The 2nd Committee is administrated by one chairperson, three vice-chairpersons and one rapporteur. The 2nd Committee regularly updates its working methods and practices to enable deeper debate and greater impact of the committee's deliberations and decisions. These efforts include streamlining the agenda, holding "question time" sessions with secretariat officials after the presentation of substantive reports and reducing the number and length of draft resolutions adopted. The Committee currently holds a dialogue with the Executive Secretaries of the Regional Commissions as well as a number of side events as part of its program of work.

The Economic and Financial Committee at its seventy-second session is chaired by his Excellency Sven JÜRGENSON of Estonia. During this session, it will discuss issues relating to economic growth and development such as macroeconomic policy questions; financing for development; sustainable development; human settlements; globalization and interdependence; eradication of poverty; operational activities for development; agriculture development, food security and nutrition; information and communications technologies for development; and towards global partnerships.

The Second Committee will also determine its stance on crosscutting issues relating to groups of countries in special situations. It will also consider the item on permanent sovereignty of the Palestinian people in the Occupied Palestinian Territory, including East Jerusalem, and of the Arab population in the occupied Syrian Golan over their natural resources.

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3. Introduction to the topic

3.1 Overview of the topic and key terms

Capital lending constitutes one of the primary components of our modern interconnected global economy. Albeit the generous lending of capital, the expected economic development has not been widely successful and even where it has occurred, the process has not been a smooth one. The evident absence of the expected economic growth pursuant to capital lending has made it difficult for the "borrower" to meet up their obligations towards their "lenders" inevitably leading to the accumulation of large debts. A notable research brought by the World Bank showcased that due to the continued lending of resources that took place between the year's 1970 and 1999, the total external indebtedness of developing countries amounted to $2.6 trillion – out of which the alarming percentage of 75% is the long-term foreign debt owed or guaranteed by governments[3]. The egregious problem of debt built-up in addition to the latest developments in the financial market worldwide has cast doubt over the advantages of lending and generated heated debate regarding the current framework for addressing sovereign debt restructuring.

[3] World Development Indicators 2001, Table 4.16, External Debt http://siteresources.worldbank.org/DATASTATISTICS/Resources/table4_16.pdf

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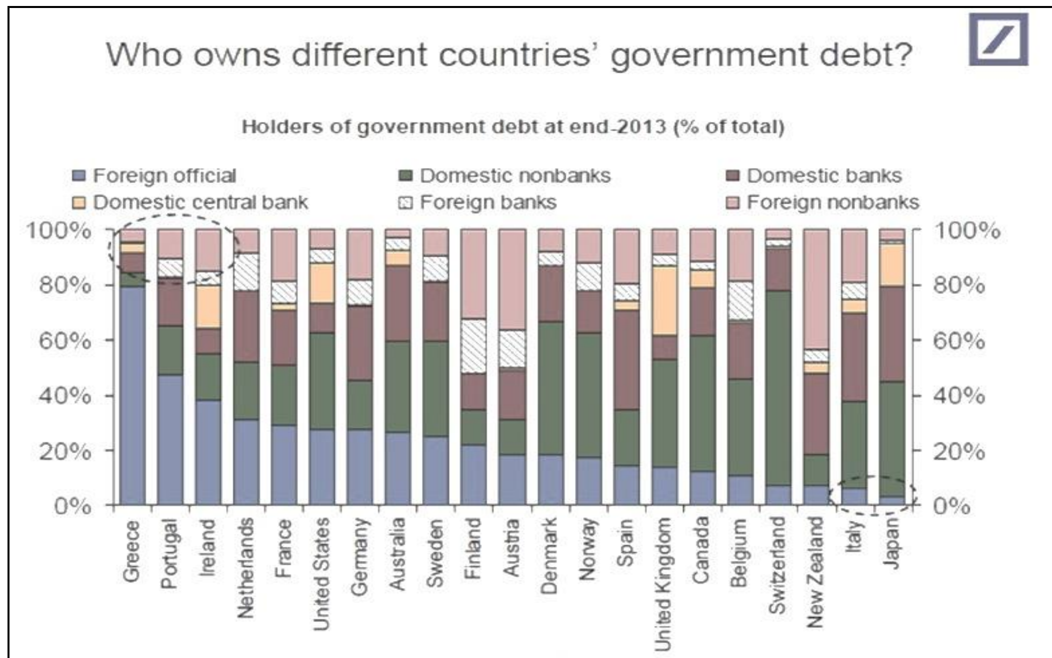

Figure 1: Who owns different countries government debt?

(Source: Arslanalp and Tsuda, DB Global Markets Research (2014)[4])

Since the 2008 global financial implosion, there has been a wave of sovereign debt defaults in both advanced and emerging market economies surfacing multiple inefficiencies in the current framework surrounding the debt restructuring workouts. Its shortcomings are now widely appreciated and there are several efforts underway to establish a new and more effective restructuring process. In the years that followed the beginning of the crisis, several countries have defaulted and restructured their sovereign debt with private creditors, including Greece, which in 2012 had the largest sovereign debt restructuring in history[5]. However, a coherent framework for this process, once a crisis begins to take shape, has not yet emerged.

[4] Arslanalp S. , Takahiro T. (2014) *Tracking Global Demand for Emerging Market Sovereign Debt* International Monetary Fund Working Paper No. 14/39 [online] Available in: https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Tracking-Global-Demand-for-Emerging-Market-Sovereign-Debt-41399

[5] Zettelmeyer J., Trebesch C., Gulati M., (2013) *The Greek Debt Restructuring: An Autopsy* Duke Law School Scolarship Digital Repository [online] 2013, pp. 2-7

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The topic at hand is of utmost importance for the international economic stability and in order to grasp its complex character it is necessary to delve into the specific terms that define it:

Sovereign debt *"is a central government's debt and it refers to how much a country owes to its outside creditors, which is why it is often used interchangeably with the term "public debt." Moreover, a sovereign debt is a depiction of an accumulation of government annual deficits, meaning it showcases the gap between a government's expenditure rate and its revenue over time"*[6].

Sovereign debt restructuring *"is an exchange of outstanding government debt, such as bonds or loans, for new debt products or cash through a legal process. It can take one or both of two forms:*

- ***Debt Rescheduling:*** *extending contractual payments into the future and, possibly, lowering interest rates on those payments.*
- ***Debt Reduction:*** *reducing the nominal value of outstanding debt"*[7].

4. Historical background and Key Actors

4.1. Actions of the United Nations

Recognizing the negative impact of procrastination in regards of Sovereign Debt Restructuring, the UN General Assembly included in the UN Millennium Declaration ***clause 16***, affirming the determination of the UN entities to dealing comprehensively and effectively with the debt problems of low -and middle-income developing countries, through various national and international measures

[6] Sovereign Debt, INVESTOPEDIA [online] Available at: https://www.investopedia.com/terms/s/sovereign-debt.asp

[7] Lombardi D., (2015) *Sovereign Debt Restructuring: Current Challenges, Future Pathways* In: Money & Banking Conference Buenos Aires June 4-5, 2015

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designed to make their debt sustainable in the long term[8]. Since then the UN General Assembly has adopted a series of Resolutions addressing the need of an efficient Sovereign Debt Restructuring mechanism[9].

In September 9th, 2014 the UN General Assembly adopted Resolution 68/304[10] under the objective of formulating a concrete framework. In October of the same year, the plurinational State of Bolivia proposed to the 2nd Committee of the G.A. and introduced draft resolution A/C.2/69/L.4 [11] on behalf of States Members of the United Nations that are members of the Group of 77 [12] deciding the establishment of an ad hoc committee open to the participation of all Member States and observers of the United Nations, with the mandate to engage in a process of intergovernmental negotiations aiming at elaborating a multilateral legal framework for sovereign debt restructuring processes in accordance with national circumstances and priorities. The primary objective of this framework would be, inter alia, to enhance the efficiency of the international financial system and procure international financial stability in order to set the ground-works for inclusive and equitable economic growth and sustainable development. In that light, the ad hoc committee on sovereign debt restructuring processes,

[8] Resolution 55/2. United Nations Millennium Declaration, clause *16. We are also determined to deal comprehensively and effectively with the debt problems of low- and middle-income developing countries, through various national and international measures designed to make their debt sustainable in the long term.*

[9] R.58/203 of 23 December 2003; R.59/223 of 22 December 2004; R.60/187 of 22 December 2005; R.61/188 of 20 December 2006; R.62/186 of 19 December 2007; R.63/206 of 19 December 2008; R.64/191 of 21 December 2009; R.65/144 of 20 December 2010; R.66/189 of 22 December 2011; R.67/198 of 21 December 2012 and R.68/202 of 20 December 2013

[10] Resolution 68/304. Towards the establishment of a multilateral legal framework for sovereign debt restructuring processes Available at: http://unctad.org/meetings/en/SessionalDocuments/ares68d304_en.pdf

[11] Draft Resolution A/C.2/69/L.4 "Modalities for the intergovernmental negotiations and the adoption of a multilateral legal framework for sovereign debt restructuring processes" Available at: http://www.un.org/ga/search/view_doc.asp?symbol=A/C.2/69/L.4/Rev.1&Lang=E

[12] The **Group of 77** (**G77**) at the United Nations is "the largest intergovernmental organization of developing countries in the United Nations, which provides the means for the countries of the South to articulate and promote their collective economic interests and enhance their joint negotiating capacity on all major international economic issues within the United Nations system, and promote South-South cooperation for development". There were 77 founding members of the organization, but by November 2013 the organization had since expanded to 134 member countries. Source: http://www.g77.org/doc/index.html

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established pursuant to G.A. Resolution 69/247 [13] of 29 December 2014, composed a comprehensive document, outlining the underlying principles of debt restructuring workouts. The aforementioned document explains that sovereign debtors are expected to act in good faith and with a cooperative spirit towards a consensual rearrangement of the debt, emphasizing that such behavior is key for the management and potentially the resolution of international financial crises.

4.2 Bretton Woods System and Sovereign Debt Restructuring

The complex process of sovereign debt restructuring is highly interconnected with the dynamics of an international financial system. The economic and political chaos that followed after the Second World War (hereinafter: WWII) determined many fundamental features of the current global economy. The imprint of the definitive interaction between the modern globalized economy and the economic reality that followed the end of WWII is evident through the contribution of the United Nations Monetary and Financial Conference at Bretton Woods.

In July 1944, representatives from 44 nations met at the Mount Washington Hotel in Bretton Woods and launched the ***International Monetary Fund (IMF)*** and ***the International Bank for Reconstruction and Development (IBRD, soon called the World Bank).*** These two institutions were created as specialized agencies of the United Nations and aim, inter alia, at ensuring the rule of law in international financial transactions, promoting market-based growth and poverty alleviation[14].

One of the basic components of the practice of the Bretton Woods system throughout the years has been adaptability. A flagrant example is the

[13] Resolution 69/247. Modalities for the implementation of resolution 68/304, entitled "Towards the establishment of a multilateral legal framework for sovereign debt restructuring processes" Available at: http://unctad.org/meetings/en/SessionalDocuments/ares69d247_en.pdf

[14] (2016) *Bretton Woods Monetary Conference, July 1-22, 1944* World Bank Group Archives Exhibit Series Available in: http://documents.worldbank.org/curated/en/538791468000300309/pdf/104697-WP-PUBLIC-2008-07-Bretton-Woods-Monetary-Conf.pdf

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establishment of informal and ad hoc machinery intended to address alarming socio-economic issues that emerged in the past decades linked to persistent poverty and instability that evolved into financial breakdowns in multiple developing markets. Their objective was to design and moderate efficient processes of restructuring international debt when necessary, in order to facilitate the process of recovering from these financial implosions. These were the ***Paris Club*** and the London Club. The first, created in the 1950's aimed at the restructuring of debt owed to government agencies in the wealthier and more advanced countries whereas the ***London Club*** was created in the 1970's in order to grapple with debt owed to commercial banks[15].

Despite the progress made by the Paris and the London Clubs, the global financial actors, shook by the instability linked to the Mexican Crisis (1994), began to focus their attention on debt in the form of international bonds issued by developing country borrowers, for the first time. During the Peso Crises (earlier mentioned *"Mexican Crisis (1994)"*) in the early 1990's, the United States offered very generous refinancing to Mexico so as to prevent the ripple effect a potential default would have on other developing country borrowers on the one hand and financially supported Mexico until a program of economic reforms restored the country's ability to borrow in international capital markets on the other hand[16]. The chain of events that took place at that time generated great skepticism concerning the framework for Sovereign Debt Restructuring, as the decision of the United States to offer such a generous package to Mexico facilitated private creditors to bail out, incentivizing, in that way, further imprudent lending. A series of alarming financial crashes and sovereign debt defaults that took place right before the turn of the millennium, culminating in Argentina's default in 2001, stressed out the paramount need for a comprehensive framework to address the inefficiencies of sovereign debt restructuring. ***In the***

[15] Riefel L. (1992) *Restructuring Sovereign Debt The Case of Ad Hoc Machinery* Brooking Institution Press Washington D.C.
[16] Musacchio, Aldo (2012) *Mexico's Financial Crisis of 1994-1995* Harvard Business School Working Paper [online] 2012 No. 12 (101), pp.17-20 Available in: https://dash.harvard.edu/bitstream/handle/1/9056792/12-101.pdf?sequence=1

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heart of the debate lied the key question of whether it is preferable to tackle with debt restructuring workouts via the establishment of ad hoc machinery specifically designed for each unique case or it is more efficient to address the issue through a permanent concise mechanism.

Moody's Rated Sovereign Bond Defaults since 1983

Default Date	Country	Total Defaulted Debt ($ millions)	Comments
Jul-98	Venezuela	$270	Defaulted on domestic currency bonds in 1998, although the default was cured within a short period of time.
Aug-98	Russia	$72,709	Missed payments first on local currency Treasury obligations. Later a debt service moratorium was extended to foreign currency obligations issued in Russia but mostly held by foreign investors. Subsequently, failed to pay principal on MINFIN III foreign currency bonds. Debts were restructured in Aug 1999 and Feb 2000.
Sep-98	Ukraine	$1,271	Moratorium on debt service for bearer bonds owned by anonymous entities. Only those entities willing to identify themselves and convert to local currency accounts were eligible for debt repayments, which amounted to a distressed exchange.
Jul-99	Pakistan	$1,627	Pakistan missed an interest payment in Nov 1998 but cured the default subsequently within the grace period (within 4 days). Shortly, thereafter, it defaulted again and resolved that default via a distressed exchange which was completed in 1999.
Aug-99	Ecuador	$6,604	Missed payment was followed by a distressed exchange; over 90% of bonds were restructured.
Jan-00	Ukraine	$1,064	Defaulted on DM-denominated Eurobonds in Feb 2000 and defaulted on USD-denominated bonds in Jan 2000. Offered to exchange bonds with longer term and lower coupon. The conversion was accepted by a majority of bondholders.
Sep-00	Peru	$4,870	Peru missed payment on its Brady Bonds but subsequently paid approximately $80 million in interest payments to cure the default, within a 30-day period.

Figure 2: Moody's Rated Sovereign Bond Defaultes (Source: Moody's Investor Service, Moody's Global Credit Policy (2009)[17]

4.2.1 Statutory Approach: Sovereign Debt Restructuring Mechanism

In November of 2001, Managing Director of IMF, Anne Krueger advocated a ***statutory*** scheme, labeled **Sovereign Debt Restructuring Mechanism** (hereinafter: SDRM) as a permanent regime of addressing issues surrounding sovereign bonds. According to Krueger, the primary purpose of the SDRM was to assure that debt restructuring would take place duly in an orderly fashion[18].

17 Duggar E., (2009) *Sovereign Default and Recovery Rates, 1983-2008* Moody's Global Credit Policy [online] Moody's Investor Service, Moody's Available in: https://www.moodys.com/sites/products/DefaultResearch/2007400000587968.pdf

18 Krueger A. O., (2002) *A New Approach To Sovereign Debt Restructuring* International Monetary Fund [online] 2002, pp. 28-33 Available in: https://www.imf.org/external/pubs/ft/exrp/sdrm/eng/sdrm.pdf

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4.2.2 Contractual Market Based Approach

Less than two years later (2003), emphasizing on the virtue of a ***contractual*** *(based on the clauses included in the contract signed among lending parties)* rather to the aforementioned statutory approach, the U.S Treasury Dpt. proposed a revised framework based on the introduction of ***collective action clauses*** (hereinafter: CAC) in bond contracts which would allow a super majority of bond-holders to modify key financial terms of a bond such as a change in the due date for the payment of a bond's principal or interest or a reduction of the interest or principal on the bond[19]. Another clause that would be included, according to the Treasury, is the ***initiation clause***. As its name implies, this clause describes the procedure by which debt restructuring workouts are launched. The third and final clause that was highly supported by the Treasury Department in its "contractual approach" is the ***engagement clause*** that is intended to specify the conditions under which the debtors and creditors engage in negotiations in the event of a restructuring. This clause serves the purpose of clarifying a priori the terms of the restructuring workouts and thereby ensuring to a certain extent their orderly manner. For example, an engagement clause could outline the designation of creditor representatives that will be given a seat in the bargaining table[20]. The underlying principle of this practice aims at incentivizing stronger creditor participation in the restructuring regime that is under negotiation at the time. These contractual provisions are designed in such way to provide a roadmap outlining as precisely as possible what will happen in the case a country (or its creditors) decides to restructure its debt. The sovereign borrower and their creditors would specify the details of the workouts at the moment the bonds were

19 Lee C. Burchett & **G.** Mitu Gulati, *Exit Consents in Sovereign Bond Exchanges,* 48 UCLA L. REv. 59, 63 (2000)

[20] Sedlack J., (2004) *Sovereign Debt Restructuring: Statutory Reform or Contractual Solution?* University of Pennsylvania Law Review [online] 2004, 1483 (152) Available in: http://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=3190&context=penn_law_review

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issued. Furthermore, these terms of restructuring would be binding on all holders since they are voted by a supermajority of creditors (75% usually)[21].

While the contractual approach has been proved to be a more multifaceted approach contrary to its counterpart introduced by Krueger, there is yet much work to be done in order to design a comprehensive legal framework regarding the sovereign debt restructuring process. It is important that such a framework not only incorporates the aspects that have been addressed in the past but also goes "an extra mile" in order to mitigate any other potential threats that surface[22]. Definitive examples of such threats are examined in the following chapter.

5. Breaking down the problem of Sovereign Debt Restructuring

There are several factors that make current mechanisms ineffective, the most important of which are the following:

5.1 Free-Riders

A common practice that poses a threat to sovereign debt restructuring is that of the so-called *"free riders or holdouts"*— those being often referred to as dissident creditors. In particular, if any creditor agrees to offer debt relief by reducing their claims on a

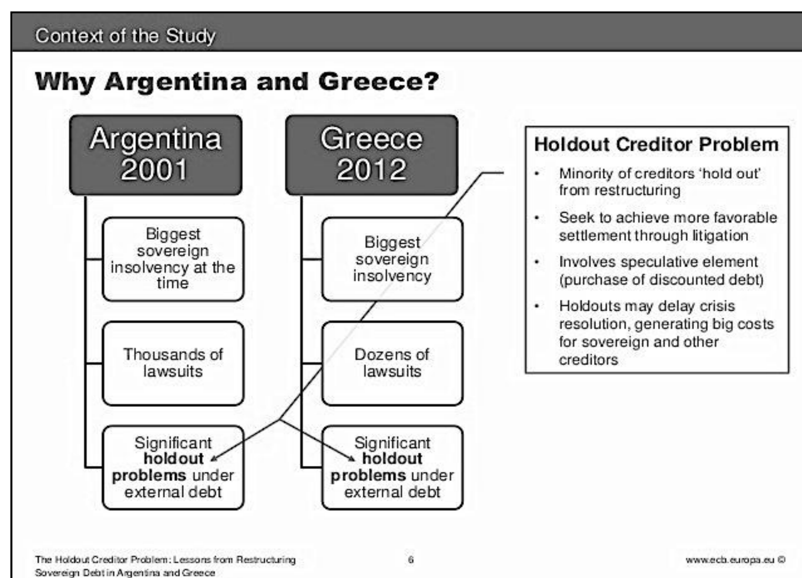

Figure 3: The Holdout Creditor Problem: Lessons from Sovereign Debt in Argentina and Greece (Source: www.ecb.europa.eu)

[21] Sharma S. D., (2004) *Resolving Sovereign Debt: Collective Action Clauses or the Sovereign Debt Restructuring Mechanism* Journal of World Trade, 2004, 38 (4), pp. 627–646
[22] Dodd R., (2002) *Sovereign Debt Restructuring.* The Financier [online] 2002, 9(1-4), pp. 3-5

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country, the value of all other creditors' claims may increase, thus generating the free-rider problem, in which some creditors do not offer debt relief in the hope that they can *"free ride"* on the debt relief offered by other creditors. A variety of informal mechanisms among creditors arose to deal with this problem. The most common amongst these mechanisms is the aforementioned introduction of the ***engagement clause***. However it remains a challenge for any future debt restructuring process to ensure full participation and remove *"free riding"* incentives.

5.2. Absence of equitable treatment amongst creditors

The absence of an enforceable set of ordinances regarding ***priority amongst multiple bond issues, intended to ensure equitable treatment among the disparate creditor groups*** is equally distortive to the orderly realization of debt restructuring workouts as any other of the aforementioned problems. There are some informal rules concerning priority that are generally followed. For instance, International Financial Institutions (hereinafter: IFIs) are de facto given priority in comparison with other external claims. However there are no rules that determine how a sovereign should treat ***their unsecured domestic debt vis a vis their unsecured external debt***, and the existing framework for coordinating the restructuring of ***external private debt and external debt owed to other governments*** is under considerable strain [23]. The evident vacuum in a predetermined priority structure can make it difficult to reach agreement on a restructuring, since the debtor and its creditors have to agree in broad terms on how different creditor groups should be treated before they can move on with negotiating financial terms.

[23] Roubini N., Sester B. (2003) *Improving the Sovereign Debt Restructuring Process: Problems in Restructuring, Proposed Solutions, and a Roadmap for Reform In: Improving the Sovereign Debt Restructuring Process* Paris, March 9, 2003 Institute for International Economics and Institut Français des Relations Internationales 2003, pp. 4-7

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5.3 Champerty defense weaknesses

Champerty and maintenance refer to doctrines in common law jurisdictions, such the legal systems of the USA and the UK, that aim to prevent the practice of litigation with no just cause. Technically, third parties are prohibited from funding an unconnected party's litigation under the doctrines of maintenance and champerty. More specifically, maintenance refers to an unconnected third-party assisting to maintain litigation, by providing, for example, financial assistance. Champerty is an aggravated form of maintenance, where a third-party pays some or all of the litigation costs in return for a share of the proceeds. In modern idiom maintenance is the support of litigation by a stranger without just cause[24].

"*The distinguishing feature of champerty is the support of litigation by a stranger in return for a share of the proceed". — Lord Justice Steyn, Giles v Thompson*

Especially regarding sovereign debts, even though any state's international assets and diplomatic property are considerably protected from litigation, the develepoment of advanced legal strategies for encouraging debt repayment incentivizes creditors to go to court in order to lay claim on the indebted state's few remaining assets. One asset that is often targeted by creditors in these cases are the funds associated with the service of the new loans. Regardless of whether these funds can be seized, some creditors have had success in pursuing court action that blocks the disbursal of these funds. For example, in the case of Elliott Associates v. Peru[25], funds that were intended to be used for interest payment on newly rescheduled debt under the Brady plan were frozen. As a result, Peru was

[24] *An end to historic rules preventing third-party funding?* Norton Rose Fullbright [online] Available in: http://www.nortonrosefulbright.com/knowledge/publications/142438/maintenance-and-champerty

[25] 948 F. Supp. 1203 (1996) ELLIOTT ASSOCIATES, L.P., Plaintiff, v. The REPUBLIC OF PERU, Defendant.
ELLIOTT ASSOCIATES, L.P., Plaintiff, v. BANCO DE LA NACION, Defendant. Nos. 96 Civ. 7916 (RWS), 96 Civ. 7917 (RWS). United States District Court, S.D. New York. December 13, 1996.
More Information: https://law.justia.com/cases/federal/district-courts/FSupp/948/1203/2099118/

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forced to settle with Elliot and Associates in full so as to avoid default on the Brady Bonds[26].

Champerty has evolved into a principal threat to orderly debt restructuring in the past decade. The successful outcome of Elliot and Associates and other similar actions has generated the widespread use of litigation during or even before the sovereigns enter in debt restructuring negotiations. More than fifty cases have been filed over the past years against ***Heavily Indebted Poor Countries,*** thus is essential to come up with efficient proposals that could minimize the risk of such forms of litigation through a multilateral forum, which would, in turn, ensure that debt restructuring is not affected by third parties with no connection to the case or no just cause. This development can also be linked to the appearance of ***vulture funds*** (see below: 5.6).

5.4 Difficulties in creditor-debtor policy harmonization

The difficulty to coordinate the steps that creditors agree to take towards restructuring with the steps that the debtor agrees to take to increase its ability to pay, poses challenges to collective action in debt restructuring. It can be a source of delay. It is very common in the case of default, that the ***policy guidelines proposed by the creditors cannot be implemented by the debtors***. This difficulty in harmonizing the restructuring policy of both negotiating parties is mainly due to the ***lack of liquidity***. In an attempt to ensure the timeliness of debt restructuring and mitigate the aforementioned inconsistencies between creditor-debtor policies, the IMF enhances the sovereigns' program of policy reform ***by offering new capital or refinancing the existing exposure.*** However this practice exercised by the IMF is neither a solution to the inherent difficulties of coordinating the

[26] A bond issued by the International Bank for Reconstruction and Development to Latin American countries starting in 1989 and continuing into the 1990s. It effectively refinanced the bonds issued by Latin American countries after many defaulted on their national debt in the 1980s. Many bonds issued in the region prior to this were illiquid; Brady bonds were tradable and, for that reason, were more attractive to investors. Because many of them were guaranteed by U.S. Treasury bonds, they also carried less risk. In 1999, Ecuador defaulted on its Brady bonds. However, in 2003, Mexico retired its Brady bond debt completely. *Source: The Free Dictionary by FARLEX*

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various demands for policy reform that come from the disparate groups of private creditors, nor does it facilitate the process of debt restructuring. Hence it is essential to modify the current framework so as to ensure that both actors of the restructuring negotiations, those being creditors and debtors, are on the same page in terms of policy and underline the fact the demand for ***policy reforms put out by creditors should not exceed the debtors' capacity in capital.***

5.5 Distortive Credit Default Swaps (CDSs)

With the term ***credit default swap*** (hereinafter: CDS) we are referring to *a certain type of swap that serves in transferring the credit exposure of fixed income products between two or more parties*[27]. In particular, the buyer of the swap is bound to makes payments to the swap's seller up until the maturity date of a contract. Meanwhile in the most likely scenario of default, the seller agrees to pay the security's premium on behalf of the buyer as well as all interest payments that would have been paid between the time of the default and the contract's maturity date. It is therefore evident that in the case of sovereign debt, ***the state in debt would be highly benefited in the event of a default if there were to be CDS's introduced in the initial contract because the payment of CDSs would be activated in such an event.*** That being said, it goes without a doubt that CDSs provide strong motive ***to debtors*** to delay the debt restructuring workouts, thus hindering orderly negotiations. Furthermore, even in the case that debt restructuring workouts are launched duly, the potential activation of CDSs offers ulterior motive and makes the real economic interests of those who have a seat at the restructuring bargaining table unclear. The incentives related to the existence of CDS's generate doubt over the agenda of the states negotiating the debt restructuring and stand as an important impediment to the achievement of the best possible outcome.

[27] Investopedia *Breaking Down Credit Default Swaps (CDSs)* [online] Available at: https://www.investopedia.com/terms/c/creditdefaultswap.asp

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5.6 Vulture Funds and the Heavily Indebted Poor Countries Initiative (HIPC)

Figure 4: Vulture Funds Illustration by Tom Halliday (Source: www.independent.ie)

*The term **vulture funds** is used to describe entities that purchase distressed debt by paying significantly below its face value, and then seek to recover the full amount, often through litigation.* [28] Their modus operandi goes as followed: firstly, they purchase distressed debt at deep discounts and refrain from any contribution to the restructuring negotiations, and then pursue full value of the debt often at face value plus interest, arrears (overdue payments) and penalties through litigation, if necessary. The practice of vulture funds has a negative spill over both on other creditors and on the indebted countries themselves. More precisely, hold-out behavior by vulture funds not only delays restructuring but also poses an obstacle to the achievement of the desired outcome. What is more, vulture funds do not only initiate litigation against debtor countries but also pursue the private sector by targeting solvent companies that do business with the governments of the indebted states[29].

From a historical standpoint, vulture funds became a concern for the IFI's pursuant to the Heavily Indebted Poor Countries initiative (hereinafter: HIPC) when donor countries and multilateral institutions such as the Bretton Woods

[28] NASDAQ Financial Glossary [online] Available in: http://www.nasdaq.com/investing/glossary/v/vulture-fund

[29] Unknown (2017) *Vulture Funds in the Sovereign Debt Context* African Legal Support Facility, African Development Bank Group [online] Available in: https://www.afdb.org/en/topics-and-sectors/initiatives-partnerships/african-legal-support-facility/vulture-funds-in-the-sovereign-debt-context/

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Institutions cancelled more than $90 billion in debt[30] to poor countries leaving space for allowed vulture funds to acquire some of this debt and insisted on full repayment from countries they targeted[31]. Since then various HIPC have been prey of vulture funds including Cameroon, Ethiopia, Sudan, Uganda and war-torn Democratic Republic of Congo, whose government was faced upon fines that added up to almost $20,000/ week, in 2009, in a case brought by a New York-based vulture fund regarding debt that dated back to Tito's Yugoslavia in the 1980s[32].

Although a joint essay produced by the IMF and the World Bank[33] showcased a significant reduction in the number of frivolous litigation by vulture funds, they continue to pose an important threat to orderly debt restructuring. The need for adequate modalities in existing legal frameworks addressing the issue and requiring of commercial creditors to comply with the terms of international debt cancellation schemes is evident.

[30] Economic Policy and Debt, Frequently asked Questions, World Bank [online] World Bank Website Available in: http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEBTDEPT/0,,contentMDK:20259564~pagePK:64166689~piPK:64166646~theSitePK:469043,00.html

[31] Tran M. (2011) *Can vulture funds be prevented from preying on poor countries?* The Guardian [online] Available in: https://www.theguardian.com/global-development/poverty-matters/2011/nov/16/can-vulture-funds-be-prevented

[32] Stewart H., Seager A., (2009) *Vulture fund swoops on Congo over $100m debt* The Guardian [online] Available in: https://www.theguardian.com/world/2009/aug/09/congo

[33] Staffs of IDA and the IMF , Canuto O., Moghadam R., (2010) *Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI)—Status of Implementation* INTERNATIONAL DEVELOPMENT ASSOCIATION AND INTERNATIONAL MONETARY FUND [online] Available in: http://www.imf.org/external/np/pp/eng/2010/091410.pdf

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	Argentina 2001, 2005	Uruguay 2003	Dominica 2004	Seychelles 2009	Greece 2012
Restructuring duration (mos)	42	2	15	19	11
Haircut (%)	76.30%	9.80%	54%	56.20%	79%
CACs triggered	Yes	Yes	Yes	Yes	Yes
Holdouts (%)	24%	7%	28%	16%	3%
Participation Rate (%)	76%	93%	72%	89%	95%
Litigation cases	>100	1	1	0	0

Figure 5: Recent Debt Restructurings

(Source: Ratna S., IMF Research: "A Survey of Experiences with Emerging Market Sovereign Debt Restructurings" (2012)[34]

6. Towards more efficient intergovernmental negotiations

A properly designed framework regarding intergovernmental negotiations for debt restructuring could strengthen the links that support our globalized economic system and ensure sustained economic growth. Furthermore if debt restructuring negotiations were to be done rapidly and in an orderly manner, sovereign borrowers would be more willing to address deteriorating debt profiles duly. That being said, it is essential to address certain questions in order to detect the fundamental components of efficient and viable intergovernmental negotiations.

[34] Ratna S., (2012) *IMF Research: "A Survey of Experiences with Emerging Market Sovereign Debt Restructurings"*

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First and foremost, when it comes to sovereign debt workouts it is important to clarify ***who is faced upon the responsibility of initiating the restructuring workouts***. Guidelines and concrete criteria concerning whether the decision to enter into workout procedures lies exclusively in the discretion of the debtor or government or do international instruments such as the aforementioned Bretton Woods Institutions play an important role in determining the necessary time to launch negotiations on debt restructuring.

In addition, as ***equitable treatment*** towards disparate creditors is key to foster fruitful negotiation, a system for comparing debt of different types and maturities, is a requirement for any debt workout. Recent experience from the Greek Debt Crises has shown that the multitude of different types of debt owed to several disparate creditors generates the need for the establishment of solid criteria that would determine the priority that would be given to the creditors as of the launching of negotiations. In order to avoid such frustration, it is anticipated of the negotiating parties examine ***a priori the terms by which foreign and domestic debt will be treated and clarify whether restructuring negotiations address only the issue of bonded debt or the cases of syndicated loans and bank credits will be discussed as well.***

In the off chance that equitable treatment does not prevent friction between the negotiating actors, ultimately the effectiveness of the negotiations relies on the existence of ***adequate means to resolve possible disputes that might emerge***.

Moreover, given that debt workouts require the collective consent of various disparate creditors to be given on pivotal actions, it is necessary to ***clarify a priori the terms of the voting on the substantive decisions*** made during intergovernmental negotiations (voting rights and majority requirements) as well as ***determine their representation.***
Furthermore, the protection of a debtor remaining assets from litigation initiated by the creditor during the time of (or prior to) negotiations, is key to orderly restructuring. Therefore, it is necessary to ***foster effective mechanisms with the***

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purpose of detecting and mitigating litigation by dissident creditors of vulture funds.

Finally, sovereign debtors may often be in need of access to new capital during the time of the restructuring process. Even though these resources have been traditionally provided by the official sector, experience indicates that new money from private sources will probably not be sufficient, thus rendering this issue an important aspect of the topic area that needs to be properly addressed. That being said it is pivotal to delve into ***ways to provide financing to indebted states during the time of restructuring workouts.***

7. Conclusion

Borrowing and lending is fundamental for sustainable development in our modern interconnected economy. The process of capital lending between states aims at ensuring the allocation of resources worldwide and subsequently galvanizing economic growth. In practice, however, experience has shown that debt situations often hinder sustainable development rather than alleviate the economy of the involved parties. Various sovereign debts that defaulted in the past have not only generated debate amongst specialists, policy makers and governmental officials throughout the years following the second world war, but inconsistencies and weaknesses of debt restructuring have also surfaced inefficiencies in the existing mechanisms, that lead to significant economic implosions across the world. Resolving current problems with sovereign debt requires adherence to a set of principles for each step of a sovereign debt restructuring workout. Such principles include impartiality, legitimacy, transparency, good faith and sustainability. In order to minimize the impact of default sovereign debts, it is necessary to focus on lessons we've learned from the past and adapt to the rapid socio-political shifts that occur daily in the present.

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8. Points to be addressed

In order to facilitate your familiarization with the topic, it would be constructive to address certain questions, however they are not intended to limit your complementary research or in any case forge your perspective. These questions are the following:

- What are the conditions nowadays worldwide that reaffirm the need for a concise and comprehensive legal framework for sovereign debt restructure?
- What lesson have we learnt from the inefficiency of the SDRM and the CAC approach to sovereign debt restructuring?
- What actions can be taken in order to encourage creditors to offer debt relief and prevent them for relying on the debt relief offered by other creditors *(free-riders problem)* ?
- Which should the priority criteria be amongst the creditors in order to achieve equitable treatment?
- How can the international community contribute to safeguard sovereign immunity from frivolous litigation on behalf of creditors?
- How can harmonization between creditor-debtor strategies of debt repayment be achieved in order to shape an orderly restructuring policy?
- How can the case of Credit Default Swaps be addressed from international actors?
- What are the weaknesses of the IFI system that set the groundwork that allow the malpractice of "vulture funds"?
- Who should be faced upon the responsibility to determine when it is time to launch negotiations on debt restructuring?
- How can friction between the negotiating parties be avoided?
- What should the stance of the committee under session be regarding whether each debt restructuring procedure should cover only foreign debt or should it require equivalent treatment for domestic debt? Shall it include only bonded debt or also syndicated loans and bank credits?

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- Which should the terms of voting upon substantive decisions be amongst the creditors?
- How should the representation of creditors be proportionately distributed during negotiation?
- Taking into consideration that sovereign debtors are often in need of new capital during debt restructuring negotiations, how and to what extent should this new financing be assured?

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