# Conference on Sovereign Debt Restructuring: Asking the right questions

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Managing Director of the International Monetary Fund Christine Lagarde waits for the start of a media conference after a meeting of eurogroup finance ministers in Brussels. (AP Photo/Virginia Mayo)

I recently attended a *Conference on Sovereign Debt Restructuring* that was jointly organized by the Brevan Howard Center for Financial Analysis, the University of Chicago Booth School of Business and the International Insolvency Institute in London on March 26-27, 2015. Speakers included debt restructuring gurus Lee Buchheit, Michael Dooley, Anna Gelpern and Mitu Gulati. The conference focused on recent efforts to improve the governance of sovereign debt crises and on remaining gaps in the debt restructuring framework.

The current contractual, market-based approach to debt restructuring is not always able to resolve collective action problems, especially in pre-default cases. The prospect of generous official sector liquidity support has the potential to delay politically difficult decisions, with the result that restructurings tend to be "too little, too late". Hence the IMF's proposal for debt re-profiling through a standstill in cases where debt sustainability is unclear, to avoid using Fund resources to bail out private creditors in cases where the debt turns out to be unsustainable, as in Greece.

One way to collective action problems and expedite debt restructurings is to introduce a statutory framework, similar to a domestic bankruptcy procedure, like the SDRM proposed by the IMF in the wake of the Argentine default in 2001. However, in the absence of consensus on reviving the SDRM or adopting various types of court and arbitration measures, efforts have focused on improving the

existing market-based, contractual framework through modifications in the Collective Action Clauses (CACs)[1] and greater clarity in the interpretation of pari passu clauses in bond covenants. To expedite debt restructuring negotiations and secure creditor participation, the International Capital Markets Association has proposed a new market standard based on “single limb” aggregation clauses in CACs, which would thwart efforts by vulture funds to acquire blocking minorities in individual bond series and hold out for a better deal.

Participants stressed the need to limit opportunistic behavior that could disrupt restructurings acceptable to the majority of creditors. While single-limb aggregation clauses is a step in the right direction, it is no panacea as the old debt will take decades to mature. Moreover, in the absence of binding international agreements, there is no way to enforce debt service payments on sovereign debtors. Waivers to sovereign immunity would help the enforceability of contracts, along the lines of the aircraft financing protocol that permits aircraft to be seized in the event of non-payment. Opposition to a statutory approach could be overcome if only a few elements were adopted to fill the gaps in the contractual approach, such as the absence of a dispute-settlements body.

The conference was followed the next day by a breakfast meeting organized by CIGI, which provided an opportunity to follow-up discussion, including areas for further research. Ex ante solutions to sovereign distress could be further explored, including the IMF’s proposal for bail-in of private creditors in the event debt sustainability is uncertain, and the joint proposal by the Bank of Canada and the Bank of England on “sovereign cocos” (state-contingent bonds in which face value haircuts and maturity extensions are automatically triggered when pre-defined debt to GDP ratio thresholds are breached).

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[1] CACs help overcome creditor coordination problems through amendments in the terms of the bonds that are binding on all holders, including those who voted against any such amendment.