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EQUITABLE GROWTH, FINANCE & INSTITUTIONS NOTES

Potential Statutory Options to Encourage Private Sector Creditor Participation in the Common Framework

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Contents

The G20's Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative (DSSI), known as the Common Framework (CF), was launched in November 2020. Its main aim is to strengthen the international debt architecture for the world's poorest countries. The framework provides a support structure for official creditor coordination to facilitate timely, orderly, and durable debt treatment and to forge the principles of fair burden-sharing across official and private sector creditors. Only three debtor countries have so far requested treatment under the Common Framework (Chad, Zambia, and Ethiopia) and the process for each of these countries has suffered delays. Limited private sector participation has contributed to the delays.

This note takes stock of the inherent imbalance in sovereign debt restructurings between debtor countries and commercial creditors, and of the longstanding challenges with commercial creditor participation in international debt initiatives. It distinguishes between the two approaches to alleviate concerns with holdout creditors in sovereign debt restructuring: contractual (voluntary) approaches and statutory (legal and therefore mandatory) approaches. The international community generally favors contractual approaches to resolve sovereign debt problems. Contractual approaches rely on good faith and have focused on the use of collective action clauses (CACs) in sovereign bonds that allow a supermajority of bondholders to impose restructuring terms on minority holdout creditors. Statutory approaches use specifically designed changes to domestic legislation to incentivize private sector creditor participation in sovereign debt restructurings.

This note presents four statutory approaches that countries can consider adopting to encourage private sector creditor participation in the Common Framework. These approaches share a common policy basis: they seek to shield taxpayers of CF creditor countries from exploitation by minority holdout creditors. These approaches seek to limit the amounts that a creditor can try to recover in a legal proceeding outside the Common Framework process: (i) legislation to codify a duty on creditors to cooperate in the context of sovereign debt restructuring; (ii) legislation to limit the amount that a creditor can seek to recover in a legal proceeding if an agreement is reached with a majority of creditors; (iii) legislation to immunize the sovereign debtor's assets from seizure where said sovereign debtor has already initiated an orderly sovereign debt restructuring process with its private creditors in good faith; and (iv) legislation to retrofit collective action mechanisms into existing debt and debt-equivalent instruments.

>>> Background

International sovereign debt restructuring involves an inherent imbalance between debtor countries and creditors because bankruptcy regimes do not apply to sovereign nations. Bankruptcy regimes offer a new start to debtors unable to repay all their debts; some debts are extinguished and creditors can obtain some level of repayment. These regimes demand full cooperation from all creditors and preclude opportunistic, exploitative behavior by individual creditors. National bankruptcy courts can impose debt restructuring terms to enforce this mandate despite creditor objections (a so called "cram-down"). The international sovereign debt resolution (ISDR) architecture is not governed by a centrally managed bankruptcy regime, but rather relies heavily on negotiated outcomes based on norms and practices that have been informed by outdated financing sources, instruments and techniques. This ISDR architecture also requires the willingness of individual creditors to participate in sovereign debt workouts and does not include a cram-down mechanism. As a result, debtor countries that need debt restructuring and their creditors can be left at the mercy of individual creditors that decline to join a negotiated and consensual restructuring (so called holdout creditors). These creditors "hold out" from the main restructuring on the expectation that the sovereign will be more likely to pay them in full if the sovereign receives debt relief from most of its other creditors.

Approaches to alleviate concerns with holdout creditors can be contractual or legal (statutory). The international community generally favors contractual approaches to resolve sovereign debt problems, these focus on good-faith discussions and negotiations, data transparency, and collective action clauses (CACs) in sovereign bonds that allow a supermajority of bondholders to impose restructuring terms on minority holdout creditors. Statutory approaches rely on legislation to address creditor holdout, and while these are rare, they have been used successfully to improve the contractual approach of CACs[1]. Statutory approaches to incentivize private sector creditor participation in sovereign debt transactions range from specifically designed domestic legislation to proposals for centrally managed sovereign bankruptcy frameworks similar to the Sovereign Debt Restructuring Mechanism (SDRM) proposed by the IMF in 2001. The international community has rejected the idea of a centrally managed sovereign bankruptcy regime; this note will look at specifically designed domestic legislation.

Longstanding challenges dominate commercial creditor participation in international debt initiatives. The Heavily Indebted Poor Countries Initiative (HIPC Initiative), adopted in 1996 and enhanced in 1999, requires debtor countries to seek relief from commercial creditors on terms consistent with the Initiative's full delivery of debt relief. Commercial creditor participation has challenged the HIPC Initiative since its inception, and some commercial creditors and distressed-debt funds have even engaged in litigation against HIPC borrowers.

The G20's Debt Service Suspension Initiative (DSSI), launched in April 2020, further illustrates the challenges of private sector participation in international debt initiatives. The DSSI offered debt payment suspension on official sector debts for the poorest countries to create fiscal space to respond to the COVID-19 pandemic. The DSSI called

1. Greece in 2012 and Barbados in 2018 amended their laws to retrofit local law that governed debt with collective action mechanisms and thus facilitated restructuring.

on private creditors to provide debt payment suspension on comparable terms with official sector bilateral creditors but stopped short of requiring debtor countries to seek comparable terms. The Institute of International Finance (IIF) prepared a comprehensive toolkit to facilitate private sector creditor participation. This included: (i) the basic framework for executing the DSSI between sovereign borrowers and private creditors, (ii) a template waiver agreement, (iii) a framework term sheet for non-bonded debt, and (iv) a technical note on consent solicitations[2]. Despite the international community's call for broad participation and the IIF's active support for implementation, private sector participation in the DSSI was limited to a national development bank that participated as a private creditor.

Successful Common Framework debt restructurings will require participation by private sector creditors. In many countries, private sector creditors hold a large amount of claims that may be eligible for Common Framework treatment[3]. This is in stark contrast with the situation of private creditors when the Heavily Indebted Poor Countries (HIPC) Initiative was introduced in the mid-1990s; at that time private claims were small (averaging 5 percent of total public external debt eligible for HIPC debt relief) compared to debt owed to official creditors. Most, if not all private sector claims were in arrears and private sector creditors were not expected to help provide external financing following debt restructuring. The CF cannot succeed without the support and participation of private sector creditors.

Adjustments and mechanisms are needed to incentivize private sector participation in the Common Framework. The Common Framework requires a CF debtor country that signs a memorandum of understanding (MOU) with participating creditor countries to seek debt treatment from its other creditors that is at least as favorable as that of the MOU. This means that official bilateral creditors decide the amount of debt relief to be provided by all creditors, and the debtor country must then obtain comparable treatment from private sector creditors. Given the large amounts of debt that sovereigns owe to private creditors, the current CF approach could give rise to a group of official bilateral creditors representing a minority of claims determining the amount of debt relief that a group of private sector creditors holding the majority of those claims should provide.

To obtain buy-in from private creditors, their expectations on recovery need to be aligned up-front with the expectations of official bilateral creditors. To this end, the World Bank has proposed that private creditors engage in coordinated and simultaneous negotiations under the CF as early as possible[4]. It has also proposed introducing a single indicator of NPV reduction based upon a common discount rate as the only measure of comparability of treatment.

Even if the CF is adjusted and can secure private sector support, individual creditor participation remains voluntary but the debtor country "is required" to seek from them debt treatment that is at least as favorable as the treatment agreed in the MOU. The experience with the HIPC Initiative, DSSI, and the attempted restructurings under the CF shows how some private creditors may refuse to participate in the Common Framework and provide comparable debt treatment or delay the process. It also shows how some creditors may undermine equitable burden sharing by pushing for more favorable repayment terms than participating creditors. It is therefore essential to identify additional mechanisms to incentivize private sector creditor participation.

Specifically designed statutory measures have been successfully used to incentivize private creditor participation in euro area bonds and in sovereign debt restructurings governed by domestic law. An important example of a statutory approach to mitigate holdout creditor risk is the adoption by treaty of a mandatory standardized collective action clause (CAC) in all euro area government securities[5]. As a result of Article 12(3) of the Treaty Establishing the European Stability Mechanism (ESM), CACs are now required for all securities issued by euro area member States with a maturity greater than one year, and member States have now agreed to amend the ESM treaty to require single-limb CACs from 2023 onwards. Other examples include local law amendments in Greece in 2012 and Barbados in

2. IIF published the Terms of Reference for Voluntary Private Sector Participation in the DSSI in May 2020, with a basic framework for how the DSSI could be executed between sovereign borrowers and private creditors. In July 2020, the IIF published a Template Waiver Agreement to be used in connection with bilateral and syndicated loan arrangements to waive default events that could arise from a sovereign creditor's announcement of its intention to participate in the discussions with the official sector, and any agreement with the official sector. In December 2020, the IIF published (i) an addendum to the TORs, (ii) a Framework Term Sheet for a voluntary debt service suspension framework agreement for non-bonded debt, and (iii) a technical note on consent solicitations to inform sovereign issuers of aspects to be considered prior to embarking on a process of soliciting the consent of bondholders to suspend debt service on DSSI terms.
3. Based on World Bank IDS, as of December 2020 the amount of public and publicly-guaranteed debt held by private sector creditors exceeds that held by bilateral creditors in approximately one quarter of DSSI eligible countries.
4. See recent World Bank note: https://documents1.worldbank.org/curated/en/426641645456786855/pdf/Achieving-Comparability-of-Treatment-under-the-G20-s-Common-Framework.pdf).
5. In general, CACs allow for a supermajority of bondholders to impose restructuring terms on minority holdout creditors.

2018 to retrofit local law governed debt with collective action mechanisms to facilitate restructuring.

In addition to adjusting the CF to allow up-front alignment of recovery expectations, G20 countries could consider enacting legislation to encourage private creditor participation in the Common Framework. This legislation would seek to inhibit preferential recoveries if a creditor chooses not to participate in a CF debt restructuring. Without broad private sector support of the CF, statutory approaches to incentivize private sector creditor participation could be perceived as an imposition on creditors holding the majority of claims by creditors representing a minority of those claims. CF-based statutory options, therefore, assume that the CF is adjusted to ensure broad private sector creditor support and would focus on preventing holdout creditors. To facilitate consistent adoption and implementation of statutory measures across key jurisdictions, the Common Framework should also include a straightforward methodology for assessing Comparability of Treatment (COT) between the debt relief to be provided by official creditors, and the debt relief to be provided by commercial creditors[6]. CF-based statutory approaches must be carefully structured to minimize unintended negative side effects, including on secondary markets and the future capacity of sovereign borrowers to tap international debt markets. Statutory approaches should seek to facilitate an effective voluntary debt restructuring agreement by incentivizing creditor participation in the Common Framework and fair burden-sharing among creditors.

There are strong policy justifications for national legislatures to consider enacting legislation to encourage private creditor participation in the Common Framework. As part of the Common Framework creditor countries have agreed to reduce or stretch out their taxpayers' claims against the debtor country. Private sector creditors should not be allowed to, in effect, exploit those taxpayer concessions by insisting on a preferential monetary recovery. Moreover, the success of private sector creditors in obtaining a preferential recovery will reduce the likelihood that a CF debt workout will be successful in restoring the debtor country to debt sustainability and that, in turn, increases the chances that the debtor country will need to seek further concessions from those same taxpayers. These statutory options can be viewed as measures taken by national legislatures to shield their own taxpayers from exploitation by third parties — something that national legislatures do all the time.

Statutory measures adopted in the legislation of financial centers across the world could help protect sovereign debtor countries from the actions of a few holdout creditors. Significant volumes of sovereign debt are governed by the laws of key jurisdictions, such as New York and England, and sovereign assets are frequently located in financial centers across the world. Statutory measures adopted in these key jurisdictions can have a significant impact. When sovereign debt restructuring becomes necessary, most private sector creditors engage in good faith voluntary negotiations. Only a small minority seek to recover preferential amounts at the expense of other private sector creditors. Statutory measures that disincentivize this refusal to participate in sovereign debt restructurings favored by a majority of private creditors will remove some of the leverage that holdout creditors have under the current ISDR architecture.

6. See Rivetti, at: https://documents1.worldbank.org/curated/en/426641645456786855/pdf/Achieving-Comparability-of-Treatment-under-the-G20-s-Common-Framework.pdf

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Potential Statutory Options

Key financial centers can explore the following statutory measures: (i) legislation to codify a duty on creditors to cooperate in the context of sovereign debt restructuring; (ii) legislation to limit the amount that a creditor can seek to recover in a legal proceeding if an agreement is reached with a majority of creditors; (iii) legislation to immunize the sovereign debtor's assets from seizure where said sovereign debtor has already initiated an orderly sovereign debt restructuring process with its private creditors in good faith; and (iv) legislation to retrofit collective action mechanisms into existing debt and debt equivalent instruments.

1. Creditors' Duty to Cooperate in a Sovereign Debt Workout Process

Legislate a duty on all sovereign borrower creditors to act in good faith and participate in debt workouts on comparable terms with other creditors if the country's debt is assessed as unsustainable. Given the lack of a sovereign bankruptcy framework, the duty on parties to a sovereign debt contract to act in good faith can be considered to imply a duty on creditors to cooperate in a sovereign debt workout process, and to not exploit concessions made by other creditors. The duty on parties to a contract to act in good faith is included in many legal systems. New York commercial law provides that: "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement." (NY UCC§1-203). Good-faith debt restructuring negotiations is also an industry principle and is one of the essential cornerstones of sovereign debt crisis management and resolution under the private sector's Principles for Stable Capital Flows and Fair Debt Restructuring[7]. Legislation could be passed in key financial centers, such as New York, confirming the existence of this implied duty to cooperate in a sovereign workout process when certain conditions are met. In the context of the Common Framework, the legislation could provide that a creditor is under a duty to cooperate in a Common Framework debt restructuring if the debtor country's debt has been assessed as unsustainable by the joint IMF and World Bank DSA and the creditor was invited to participate on comparable terms.

In contrast to other jurisdictions like New York, English law does not impose a general obligation to negotiate or perform contracts in good faith[8]. The English law approach is based on the desire to avoid uncertainty and addresses: (i) the validity and efficacy of commercial contracts, (ii) the need to preserve the freedom of the parties by allowing them to act in accordance with their own commercial and self-interests, and (iii) the difficulty in defining precisely what "good faith dealing" means. English courts, however, have increasingly shown willingness to give effect to specific contractual terms requiring parties to act in good faith if the contract expressly provides for that duty, if it specifies what acting in good faith means, and also includes objective criteria. English law's reticence to recognize a general duty of good faith should not *per se* be an impediment to legislate sovereign creditors to participate in Common Framework debt restructurings. Following the approach used by English courts to recognize an express duty in contracts, legislation could

7. Principles for Stable Capital Flows and Fair Debt Restructuring, 2021 Report on Implementation by the Principles Consultative Group.
8. *See* Calvert, Bond, and Houlihan, *Good Faith in English Contract law* (March 1, 2022), The National Law Review, Volume XII, Number 146 available at: https://www.natlawreview.com/article/good-faith-english-contract-law#:~:text=Under%20English%20law%2C%20there%20is,the%20negotiation%20of%20commercial%20contracts.

establish an express duty on sovereign creditors (and sovereign debtors) to act in good faith and cooperate in Common Framework debt restructurings.

Potential impact on secondary markets. Two classes of investors participate in the secondary market for the purchase of rights in distressed sovereign debt instruments: (i) those who purchase claims in the passive hope that they will be able to sell their claims for an amount that will reimburse their acquisition cost, cover the cost of financing the purchase price for the time they hold it, and produce a profit for the purchaser (distressed debt investors); and (ii) those who purchase claims at a deep discount with the intention of forcing a settlement of the claim at a level higher than that accepted by more passive investors (so called "vulture funds"). Distressed debt investors bring important and needed liquidity to sovereign debt markets, while vulture creditors buy claims with the express intention of seeking preferential recoveries through legal enforcement of the underlying instrument. Incentivizing private creditor participation in the Common Framework by legislating a duty on creditors of a sovereign borrower to cooperate in a debt workout is likely to have only limited impact on secondary markets for distressed debt investors.

2. Limit creditor recoveries

This would entail legislation to incentivize private sector creditor participation in Common Framework restructurings by limiting the amounts that creditors can recover in legal proceedings if an agreement is reached with a majority of creditors. Legislation in key financial centers could limit the amount that a sovereign creditor could obtain in the courts of that particular jurisdiction if a debt restructuring agreement is reached with a majority of creditors. Permissible recoveries would be tied to amounts recovered by other creditors under the Common Framework. For this to work the Common Framework needs to contemplate a straightforward and clear methodology for assessing COT between official and commercial creditors. This would facilitate a judge's decision on amounts recoverable by litigating creditors.

There are successful statutory precedents for limiting creditor recoveries. Limiting the amount that creditors can recover in legal proceedings was partially adopted by England under its Debt Relief (Developing Countries) Act 2010 (the UK 2020 Act)[9], Belgium addressed this more comprehensively in its 2015 law against vulture funds[10]. The UK 2010 Act sought to limit the ability of litigating creditors to use the English court system to try to recover in full debt eligible for debt relief under the HIPC Initiative (HIPC-eligible debt). It prevents creditors of HIPC-eligible debt from suing in English courts to enforce payment on terms more favorable than the terms agreed under the HIPC Initiative. The Belgian law is more far-reaching and applies to the debt of any sovereign, it is also focused on curtailing enforcement by secondary-market purchasers. Furthermore, it limits a creditor's ability to seek enforcement of a claim that the judge determines is clearly disproportionate to the price that the debt was purchased for in the secondary market.

The impact on distressed debt investors of limiting the amounts that creditors can recover in legal proceedings is expected to be limited. Potential negative impacts can be mitigated by restricting this option to restructurings that have been agreed to by a supermajority of creditors. The UK 2010 Act was adopted more than a decade ago and despite fears of a negative reaction by the market, it has been accepted by commercial creditors. There are, however, important differences between the HIPC Initiative and the Common Framework that may impact how commercial creditors and distressed debt investors respond. The HIPC Initiative had been in place for 14 years by 2010, but the amount of commercial debt subject to HIPC debt relief was relatively small, and there were longstanding concerns that the Initiative's goal of proportional burden-sharing among creditors was being undermined by commercial creditors pursuing litigation and getting paid back on more favorable terms than most bilateral and multilateral creditors[11]. The Common Framework is currently in the early stages of implementation, and the amount of commercial debt that may require Common Framework treatment is large. Under the HIPC Initiative, official claims made up the majority of HIPC-eligible debt, and the UK 2010 Act sought to enforce a voluntary and consensual decision of the majority of creditors on a small minority.

9. UK Debt Relief (Developing Countries) Act 2010, available at: https://www.legislation.gov.uk/ukpga/2010/22/contents
10. Loi relative à la lutte contre les activités des fonds vauteurs 2015, available at: http://www.ejustice.just.fgov.be/mopdf/2015/09/11_1.pdf#Page7
11. Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI) – Status of Implementation, Development Committee, DC20007-0021, September 28, 2007.

Given the large proportion of commercial debt that may require debt relief under the Common Framework, limiting the amounts that creditors can recover in legal proceedings should only apply to situations where restructurings have been agreed to by a supermajority of creditors. Otherwise, this statutory approach could result in an imposition by a group of official creditors representing a minority of claims on a group of commercial creditors holding a majority of those claims. Commercial creditors and distressed debt investors may be able to take comfort in the Common Framework's limited application to situations where the need for debt treatment, and its restructuring envelope will be based on a joint IMF-WB Debt Sustainability Analysis and a collective assessment of the official, participating creditors, which will be consistent with the parameters of an upper credit tranche (UCT) IMF-supported program. These stringent requirements ensure that the Common Framework will only apply in situations where debtor countries require debt restructurings. An additional element that may call for a limited negative impact on secondary markets is that distressed debt investors do not purchase claims with the intention of seeking preferential recoveries through legal enforcement of the underlying instrument.

3. Immunize Sovereign Assets from Attachment

This approach would entail adopting legislation that seeks to incentivize private sector creditor participation in CF restructurings by limiting the ability of creditors to attach or seize sovereign debtor assets. The legislation would limit a creditor's ability to enforce a judgment, instead of limiting the amount of a judgment that a creditor can obtain. Existing sovereign immunity laws already provide significant protection of sovereign debtor assets. The CF-based legislation would further immunize from attachment any assets or revenue streams of a sovereign undergoing (or that has undergone) a Common Framework debt workout if the claim holder declined to participate in CF debt restructuring on comparable terms, despite being eligible. Such legislation could be standalone, or it could be an amendment to existing sovereign immunity laws or other financial related legislation. France adopted a law in 2016 that restricts the ability of French courts to authorize seizure of foreign State assets to satisfy certain debts of an ODA recipient[12].

This approach can protect a sovereign debtor's assets even if a judgment has been rendered for a

12. LOI n° 2016-1691 du 9 décembre 2016 relative à la transparence, à la lutte contre la corruption et à la modernisation de la vie économique, available at: https://www.legifrance.gouv.fr/jorf/id/JORFTEXT000033558528#JORFARTI000033558576

higher amount. As such, it is not affecting the contractual rights of creditors, instead, it restricts some of the remedies available to creditors to enforce a judgment. This approach would be particularly impactful if adopted in jurisdictions where sovereign debtors traditionally hold assets. The Common Framework methodology would need to be straightforward and simple to assess COT between official creditors and commercial creditors under this approach, as in the case of legislation to restrict creditor rights. This would facilitate the judges' determination of which assets are to be protected from seizure.

Potential impact on secondary markets: The impact on distressed debt investors of limiting the ability of creditors to attach or seize sovereign debtor assets is expected to be limited because of existing sovereign immunity laws. As is the case with statutory measures that could limit creditor recoveries, potentially negative impacts are also mitigated for distressed debt investors because they do not purchase the claims with the intention of seeking preferential recoveries through legal enforcement of the underlying instrument.

4. Retrofitting collective action mechanisms

This approach would entail adopting legislation to retrofit collective action mechanisms into existing debt contracts. Greece in 2012 and Barbados in 2018 amended their domestic law to facilitate debt restructuring by retrofitting collective action mechanisms into debt instruments governed by their laws. In each case, the legislation provided for a dissenting minority of debt holders to be bound by the vote of a supermajority to accept a sovereign debt restructuring proposal. Proposals have been made to build on this domestic statutory approach by adopting similar legislation in jurisdictions whose laws govern significant volumes of sovereign debt. New York lawmakers have introduced draft legislation to allow unsustainable sovereign and subnational debt to be restructured through new procedures that would be added to the existing New York banking law[13].

Legislative retrofitting of collective action clauses would only apply to debt instruments governed by the laws of the jurisdiction that adopts the legislation; its impact will extend beyond distressed debt investors. A broad-ranging sovereign bankruptcy-like framework could impose collective decision-making on all creditors to a sovereign debtor regardless of the law governing the actual underlying debt instruments. Such framework could extend to official and private sector creditors, and could apply to outstanding and new debt. Targeted legislation that focuses exclusively on retrofitting a collective action clause (as in Greece or Barbados) would only apply to debt instruments governed by the laws of the jurisdiction that adopts this legislation and would not apply to debt instruments governed by the laws of a different jurisdiction. It would not apply to bilateral official debt governed by a bilateral lender's law (for example loans by the French Development Agency (governed by French law)) or to commercial debt instruments governed by different laws (an English law retrofitting CACs into English law-governed debt instruments would not apply to New York law-governed debt instruments and vice versa). The impacts of a statutory retrofitting of collective action mechanisms will extend beyond distress debt investors. Sovereign creditors are likely to view it as a retroactive impairment of contract rights in ways which they did not foreseen or expect at the time the contracts were executed.

There is also the risk that retrofitting a collection action clause could be found to be unconstitutional. The Contract Clause of the US Constitution prohibits State governments from specifically legislating to interfere with private contract rights. As such, any New York law focused on retrofitting collective action clauses would need to avoid being considered unconstitutional under this Clause.

Collective action mechanisms imposed by law on future debt governed by laws of a particular jurisdiction would not face the same legal risks and may be a more feasible option. Such mechanisms would apply to new debt only, not existing debt, and would therefore not focus on incentivizing participation in the Common Framework. Over time such mechanisms would, however, help minimize the risk of holdout creditors when a sovereign debt restructuring becomes necessary. This forward-looking approach has been adopted for euro area government securities with maturities of more than one year issued on or after 1 January 2013 by Article 12(3) of the Treaty of the European Stability Mechanism and has recently been revised to introduce single-limb CACs. There are ongoing

13. NY Senate State Bill 6627, https://www.nysenate.gov/legislation/bills/2021/S6627

discussions by sovereign debt market participants on introducing, on a voluntary basis, majority voting provisions into commercial loan agreements.

This note has focused on statutory options to incentivize private sector creditor participation in the Common Framework, equivalent options may be explored outside the Common Framework. Statutory options can seek to incentivize private sector creditor participation in debt restructuring favored by a majority of creditors, regardless of whether or not the restructuring is done under the Common Framework umbrella. This type of approach would address any potential risks inherent in CF-based statutory options; for example, that CF-eligible debt becomes a separate asset class that pays a premium over non-CF-eligible debt. Carefully designed statutory approaches that target increasing the ability to complete a debt restructuring agreed by a supermajority of creditors could improve the sovereign debt restructuring process while avoiding negative impacts on the ability of sovereign debtors to access financing. Legislation could be passed that imposes a duty to act in good faith on all commercial creditors that hold debt instruments governed by the laws of the particular jurisdiction and to participate in a sovereign debt workout on comparable terms with other creditors[14]. Legislation that limits the amount of a judgment that a sovereign creditor can obtain in the courts of a particular jurisdiction or that limits the ability of creditors to attach or seize sovereign debtor assets could be tied to amounts recovered by creditors that have restructured collectively. Collective action mechanisms can be imposed by law on all future debt governed by laws of the particular jurisdiction. Further analysis would be required on statutory options that are outside the Common Framework.

Private sector creditors are likely to resist statutory approaches, arguing that all aspects of a sovereign debt restructuring workout should be voluntary. Private sector creditors, however, do not expect a purely voluntary workout process for loans they make to entities subject to bankruptcy regimes. In fact, public policy applicable to restructurings in corporate debt workouts requires private sector lenders to abide by the decision of the supermajority of their fellow lenders. The potential options for a statutory mechanism to achieve equivalent results in the world of sovereign debt are precisely what creditors live with in all corporate loans. Relying on purely voluntary approaches developed by private sector creditors does not always deliver the expected results in a timely manner[15].

14. *See* Buchheit, Lee C. and Gulati, Mitu, *The Duty of Creditors to Cooperate in Sovereign Debt Workouts* (December 6, 2021), Virginia Public Law and Legal Theory Research Paper No. 2021-51, Virginia Law and Economics Research Paper 2021-26, available at SSRN: https://ssrn.com/abstract=3950529.w

15. In past restructurings, the average difference in NPV reduction (i.e., the haircut) between the official and the private creditors has been greater than 20 percentage points. (Schlegl M., Trebesch C., Wright M., The Seniority Structure of Sovereign Debt (2019). CESifo Working Paper No. 7632, available at SSRN: https://ssrn.com/abstract=3387668.) At times important private sector-led voluntary initiatives have failed to gain timely traction within the private sector community. Examples include the lack of private creditor participation in the DSSI, despite the IIF's comprehensive toolkit to facilitate private sector creditor participation and the delay in implementing the IIF's June 2019 Voluntary Principles for Debt Transparency covering debt financing provided by private sector entities.

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