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Governing Sovereign Debt Restructuring Through Regulatory Standards

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Abstract: In recent years, a number of costly and destabilizing sovereign debt crises – from Argentina and Greece to Ukraine – have served as a forceful reminder that the international community lacks an agreed-upon framework for resolving debt crises and, when necessary, restructuring sovereign debt in a timely, orderly, and equitable manner. To help address this apparent governance gap, the paper argues that there is an important but underutilized role for the Financial Stability Board (FSB) in governing sovereign debt restructuring. More specifically, in a governance domain that is relatively fragmented between uncoordinated, even sometimes competing, rules and rule-makers, the FSB could serve as the focal institution responsible for overseeing the coordination and further development of soft law regulatory standards for sovereign debt restructuring. The reasons for FSB governance in this domain are simple and compelling, relating to both the nature of the debt restructuring regime and its evolution to date, as well as the specific institutional features of the FSB and the core tasks it performs. Although there remains room for treaty-based organizations like the International Monetary Fund (IMF) and United Nations (UN) to develop a hard law approach to sovereign debt restructuring, the FSB, we argue, is best positioned to strengthen and oversee the existing soft law approach, which currently prevails as the modus operandi of the present debt restructuring framework.

Keywords: collective action clauses (CACs); Financial Stability Board (FSB); international standards; sovereign debt; sovereign debt restructuring.

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1 Introduction

In March 2012, more than 2 years after the outbreak of its debilitating debt crisis, Greece underwent the largest sovereign default and debt restructuring in world history (Xafa 2014). Despite providing debt relief equal to around 50 percent of national GDP (Zettelmeyer et al. 2013),[1] the restructuring proved "too little, too late" (IMF 2013), as it failed to meaningfully reduce the country's overall public debt burden. Three years later, still struggling under the weight of unsustainable debt, Greece became the first advanced economy to fall in arrears on its repayment obligations to the International Monetary Fund (IMF). As the IMF projects the debt to GDP ratio in a baseline scenario of its debt sustainability analysis to peak at 200 per cent of GDP in the next 2 years, and to hit 170 per cent by 2022, Greece is still in need of deeper debt restructuring and a more politically and economically sustainable recovery plan (IMF 2015).

Although the most dramatic, Greece has not been the only case of severe debt distress and restructuring in recent years. In 2014, Argentina relapsed into a state of "selective default" after being told by a New York court that it could not make payments to the creditors that accepted its 2005 and 2010 restructurings unless it first paid those who did not (Russo and Porzecanski 2014).[2] Similar court proceedings of holdout creditors against insolvent sovereign debtors have become more frequent, which mostly affects the poorest countries (Schumacher et al. 2014). The most recent sovereign debt restructuring deal, concluded in August 2015, saw war-torn Ukraine reach concessions from a group of the country's largest creditors, who accepted an immediate 20 per cent write-off on $18bn of the country's bonds (Moore and Buckley 2015). However, Russia, who together with its sovereign wealth fund is one of Ukraine's major creditors, signaled it would not participate in the restructuring deal.

These episodes, especially the Greek and Argentinian cases, remind us of an uncomfortable fact: the international community lacks an agreed-upon method or set of tools for resolving debt crises and, when necessary, restructuring sovereign debt in a timely, orderly, equitable, and minimally disruptive manner. In response to this newest round of debt crises and the need for better governance

1 Generally, haircuts are calculated by using *ex-ante* valuations. In some situations the interest rate at which cash flows are discounted may be high, thus resulting in a large haircut without much debt relief. Hence, while commonly used, the size of a haircut may not always be the best measure of debt relief.

2 See also See also ISDA Americas Credit Derivatives Determinations Committee. 2014. "Argentine Republic Failure to Pay Credit Event," *News Release*. August 1. http://www2.isda.org/news/isda-americas-credit-derivatives-determinations-committee-argentine-republic-failure-to-pay-credit-event.

arrangements to deal with them, a number of organizations and actors have sought to advance reforms of varying degrees of scope and ambition, from Europe's creation of new regional institutions and the IMF's revamping of its own lending framework, to the International Capital Market Association's (ICMA's) remodeling of standard sovereign bond contracts and the United Nations General Assembly's (UNGA's) resolution calling for the creation of a "multilateral legal framework for sovereign debt restructuring." While these reform efforts are promising, what they will ultimately amount to remains unclear.

Historically, the only successful reforms to create new governance mechanisms for sovereign debt restructuring have been a variety of soft law and market-based contract reforms. In this sense, soft law is a legal instrument that establishes rules which are acceptable to market players. Soft law does not develop any binding legal force, unless market actors choose to adhere voluntarily to these rules.

Whether or not this remains the case, the relative success of the soft law approach raises an issue of potential relative neglect among scholars and practitioners: that is, rather than focusing more or less exclusively on the type of solution needed – the traditional dichotomy being between contractual and statutory approaches – should we not also seek to strengthen and better coordinate the component parts of the emerging soft law regime?[3]

The need for reforms that improve the governance of sovereign defaults and debt restructurings is not an argument of this paper; it is an analytical starting point. Taking the need for some kinds of reform as given, this paper argues that there is an important but underutilized role for the Financial Stability Board (FSB) in governing sovereign debt restructuring. More specifically, in a governance domain that is relatively fragmented between uncoordinated, even sometimes competing, rules and rule-makers,[4] the FSB could serve as the focal institution responsible for overseeing the coordination and further development of soft law regulatory standards for sovereign debt restructuring. The reasons for FSB governance in this domain are simple and compelling, relating to both the nature of the debt restructuring regime and its evolution to date, as well as the specific institutional features of the FSB. There remains room for treaty-based organizations like

3 For exceptions that argue for the soft law approach to sovereign debt restructurings, refer to Guzman and Stiglitz (2015) and, also, to Schwarcz (2015) published in this special issue.

4 For the interplay of jurisdictions in the case of Argentina, please refer to "Where an American court seemingly has taken an action affecting payments on Argentinean bonds issued in other jurisdictions, such as the UK, and a British Court has ruled that they cannot do so [England and Wales High Court (Chancery Division) Decisions, Case No: HC---2014---000704]". See also Guzman and Stiglitz (2015).

the IMF and UN to develop their approach to sovereign debt restructuring, and to develop sovereign debt restructuring principles or even to establish an oversight commission that mediates between creditors (Guzman and Stiglitz 2015). At the same time, we argue that the FSB is best positioned to strengthen and oversee the soft law approach, which currently prevails as the modus operandi of the present debt restructuring framework.

This paper proceeds as follows. Section 2 provides a historical review of the various attempts to create a formal treaty-based – or "statutory" – framework for sovereign debt restructuring. It highlights some of the specific and general reasons why such efforts have repeatedly failed. Section 3 describes the existing regime for sovereign debt restructuring, focusing on the decentralized, soft law, market-based mechanisms that have emerged despite the failures to create a comprehensive hard law framework at the international level. This section suggests that soft law "solutions" to sovereign debt restructuring have reflected a dual preference held by many of the most powerful actors in this area, who on the one hand have wanted to make debt restructurings more orderly and predictable, but on the other, have preferred not to establish a binding, hard law arrangement. Section 4 discusses international financial standards, emphasizing the evolution of the standards regime and the market-oriented logic that underpins it. Here, a link is made between the standards regime and the evolving regime for sovereign debt restructuring, which is also based on soft law standards and codes that rely on a market logic to generate compliance. In Section 5, we develop the thesis of this paper; that the FSB, as the institutional anchor of the international financial standards regime, is well suited to play a productive role in overseeing the coordination and development of regulatory standards for debt restructuring. The rationale for FSB involvement in governing sovereign debt focuses on the institution's comparative regulatory advantage, its relative neutrality, and its potential as a framework for collective action. The final part, Section 6, offers some concluding thoughts.

2 The Long Search for a Hard Law Mechanism

The search for a binding sovereign debt restructuring mechanism has been ongoing for a long time. In modern history, the Mexican foreign minister, Jose Manuel Puig, was the first to suggest a statutory mechanism for sovereign debt crises in 1933 at the Pan-American Conference in Uruguay. His idea was to establish international organizations responsible for debt negotiations and agreements, in order to reduce the influence of banker's committees (Helleiner 2008: 95).

Some of the Latin American countries opposed the proposal, arguing that the support for such a mechanism would give the wrong signal to foreign investors in their countries; an argument that would be repeated in discussions of subsequent proposals. The next noteworthy suggestion for a restructuring mechanism was discussed over the course of the Bretton Woods negotiations (*Ibid*.). Following the initial blueprints for the Bretton Woods institutions, governments should be prohibited from defaulting on external debt without the approval of the IMF. However, some debtor countries argued that their sovereignty would be violated if they had to seek approval for default, or that such a provision would encourage some (bad) debtor countries to default against their creditors' interests (Oliver 1975). In 1978, the idea for a formal restructuring mechanism briefly resurfaced, when the United Nations Conference on Trade and Development (UNCTAD) called for an independent forum for the restructuring of sovereign debt. The Group of 77 (G77) developing countries picked up the proposal, but soon encountered opposition from Western creditor countries, organized in the Paris Club, and institutional private creditors, organized in the London Club. Eventually, the G77 withdrew support for the idea in 1980, and the UNCTAD proposal was abandoned.

In the 1990s and early 2000s, academics emphasized the need for a statutory approach to sovereign debt restructuring. Sachs (1995) argued that there is a "lack of standards vis-à-vis" the IMF's role as an international lender of last resort. This lack of standards would cause IMF-led debt restructurings to be woefully inadequate, especially when compared to corporate bankruptcy debt restructurings (Schwarcz 2015). Schwarcz picked up on this proposal and analyzed which axioms of bankruptcy reorganization should be applied to sovereign debt restructurings (Schwarcz 2000). The set of rules derived from this analysis notably included supermajority aggregate voting for creditors, and priority claims for financiers of a sovereign debt restructuring.

Inspired and based in part on these ideas (Rogoff and Zettelmeyer 2002), the most prominent proposal for a sovereign debt restructuring mechanism in recent history came from the IMF in the early 2000s. After a series of large-scale emerging market crises with systemic implications, US Treasury Secretary Paul O'Neill called upon the IMF to propose a formal debt workout mechanism (Hagan 2005). Consequently, then IMF deputy managing director, Anne Krueger, proposed the creation of the Sovereign Debt Restructuring Mechanism (SDRM). The SDRM would introduce a supermajority, aggregate binding voting mechanism for creditors, and essentially facilitate a quicker and more orderly resolution of sovereign debt crises. Although the proposal initially was backed by some government officials from European creditor countries, such as Germany, Italy, and the UK (Gelpern and Gulati 2004), it soon became apparent that it would not progress. The private creditor community argued that a formal restructuring mechanism would unfairly enhance the bargaining position of sovereign debtors (Dickerson 2004). Moreover, several emerging market debtors, such as Brazil and Mexico, favoured a market-based solution over a bureaucratic one. Their executive directors fought hard within the IMF's executive board to have the SDRM removed from the agenda (Gelpern and Gulati 2004; Setser 2010). Another argument was that the IMF, as an organization that lends money to debtor countries, might be biased if it controlled the SDRM (Dickerson 2004). Eventually, US public officials shifted from the supporting to the opposing faction, fearing a loss of sovereignty should the IMF have the sole power to control sovereign debt restructurings (Setser 2010). In March 2003, when a group of emerging market countries – Mexico, followed by Brazil and Uruguay – included collective action clauses (CACs) in their international bonds, some of the main stakeholders in the discussion were satisfied to have found an alternative to the politically difficult SDRM proposal (*Ibid*.; see below the discussion of CACs). The SDRM proposal was abandoned shortly thereafter.

Almost a decade later, in September 2014, the UNGA passed a resolution for the creation of a "multilateral legal framework for sovereign debt restructuring." The resolution broadly received support from the G77, while countries with major financial centers voted against it. However, there has never been agreement on substance of the initiative. Some countries, such as Argentina, wanted a binding but not comprehensive framework, while other countries, such as Russia, wanted a comprehensive but non-binding framework. The discussions of a more formal debt restructuring framework eventually led to the adoption of a new UNGA Resolution promulgating a set of non-binding principles governing sovereign debt restructurings.[5]

To sum up, there have been a handful of attempts to create statutory or treaty-based mechanisms for sovereign debt restructuring since the early 1930s none of which have proven successful. While some initiatives did gain considerable support and momentum – most notably, the SDRM proposal of the early 2000s – they were ultimately unable to mobilize a winning coalition.

Explanations for the failure to generate sufficient political support for the creation of an international bankruptcy-like mechanism point to, *inter alia*, opposition from powerful private creditors (Soederberg 2005), concerns over borrowing costs among sovereign debtors (Gelpern and Gulati 2004; Hagan 2005), and reluctance to abdicate sovereignty on the part of great powers like the US (Setser 2010). Although these actors – sovereign debtors, private creditors, and powerful

5 See UN General Assembly Resolution A/69/L.84, 10 September 2015. 6 countries (Canada, Germany, Israel, Japan, UK and US) voted against the Resolution, 136 in favor, and 41 countries abstained (see http://www.jubileeusa.org/fileadmin/UNDebtVoteRestructuring.png).

creditor-hosting countries – have not been convinced of the need for a statutory mechanism, they have maintained an interest in ensuring that sovereign debt restructurings, when necessary, are carried out in a smooth and orderly fashion that protects assets and preserves global financial stability. As a result of this dual preference – for a more orderly system in the absence of a hard law approach – debtors and creditors, with the support of the Group of Seven (G7), have worked together to develop and implement soft law, market-based mechanisms to both prevent debt restructurings when possible, and facilitate them when necessary. Over the past decade, the results of these efforts have yielded a select few mechanisms that now comprise the main tools available – short of IMF programs and Paris Club treatments – for sovereign debt restructuring. It is these mechanisms, and the soft law regime they comprise, to which we now turn.

3 The Existing Soft Law Regime: From CACs to Codes of Conduct

In terms of its content, the international regime for sovereign defaults and debt restructurings is characterized by a decentralized and non-binding set of market-based, soft law standards and mechanisms designed to promote "best practices" in sovereign lending and repayment and, when necessary, facilitate the cooperative resolution of unsustainable debt. To these ends, the main mechanisms currently used are CACs and codes of conduct.

3.1 Collective Action Clauses (CACs)

CACs are a set of legal provisions written into sovereign bond contracts at the time of issuance. As their name suggests, CACs are meant to facilitate collective action between the debtor and its creditors and among creditors themselves in the event of a sovereign debt restructuring. To achieve this, they would include provisions that (1) establish a bondholders' meeting in the event of restructuring and specify procedures for selecting the bondholders' representative (collective representation clauses); (2) prevent individual bondholders from taking the sovereign to court (majority enforcement clauses); and (3) specify the size of the (super) majority of bondholders needed to amend payment terms (majority restructuring clauses) (Das et al. 2012; Gulati and Weidemaier 2014). Notably, these first generation CACs regularly allowed voting on bond restructurings only within a single bond series. The aggregation of votes across entire bond series – a feature that would facilitate restructuring of multiple bond instruments – was not part of sovereign bond CACs in the early 2000s. Hence, CACs initially addressed the holdout problem only to a limited extent. A single creditor could buy enough bonds of a single CAC bond series to reach a blocking position so as to thwart any attempts to restructure the bond.

CACs have been a common feature of the London bond market for over a century (Das et al. 2012). But in the US, the largest market for emerging market debt, CACs did not become widely used until 2003, when Mexico became the first major emerging market debtor to include CACs in its sovereign bonds – a move that precipitated a rapid and widespread shift toward the use of CACs for emerging markets. As of June 2014 there were about USD 900 billion of outstanding foreign law bonds, of which 80 per cent included CACs (IMF 2014).

Until recently, sovereign debt crises and the attendant need for CACs were thought to be a concern limited to developing and emerging market countries. In response to the euro zone crisis, however, Europe has introduced a new requirement that all euro-zone sovereign bonds issued after January 1, 2013, include CACs (Bradley and Gulati 2013; Gulati and Weidemaier 2014). The EU CACs have a two-limb aggregation test that requires meeting a certain voting threshold in every single bond series, and a second vote of all bondholders together.

3.2 Argentina's Isolation from International Payment Systems

Around the same time as the Greek debt restructuring, a series of controversial legal rulings of the US District Court in the Southern District of New York in 2012 and 2013 and of the US Supreme Court (in the case of Argentina v. NML Capital) exposed existing weaknesses and generated new challenges in the governance of sovereign debt workouts.[6] The fact that Argentina's holdout creditors were able to secure favourable legal judgments in US courts highlighted the need to clarify the ambiguous *pari passu* clause contained in most sovereign bonds as well as

6 See US Court of Appeals 2nd Circuit decision generally confirming the US District Court in the Southern District of New York's order for injunction, by which the court directed Argentina to make a "ratable payment" to holdout creditors whenever the country pays on the bonds that it issued in 2005 or 2010 exchange offers, *NML Capital, Ltd. v. Republic of Argentina*, 699 F.3d 246 (2d Cir.2012) (NML I); see US Court of Appeals 2nd Circuit decision confirming the US District Court's revised order for injunctive relief, *NML Capital, Ltd. v. Republic of Argentina*, 727 F.3d 230 (2d Cir. 2013) (NML II) (the US Supreme Court denied Argentina's petition to review this decision in 2014); see also US Supreme Court decision holding that Argentina's foreign assets are not immune from discovery, *Republic of Argentina v. NML Capital, Ltd.*, 134 S. Ct. 2250, 189 L. Ed. 2d 234 (2014).

find stronger mechanisms with which to aggregate a sovereign's creditors and bind them to a common restructuring agreement. Beyond the permissive conditions that allowed for such a ruling, the court's decision itself had far flung implications that threatened to further complicate debt restructurings moving forward. In setting a legal precedent under New York law – the law governing a large portion of developing and emerging country sovereign bonds – that rewards recalcitrant creditors and punishes cooperative ones, the decision created a perverse yet strong incentive for all creditors to hold out from future restructurings (see, for instance, Brooks and Lombardi 2015).

The court order essentially isolated Argentina from the financial markets, and prevented the country from honoring its commitment under the restructuring deal with the vast majority of its creditors. The US Federal Court of the Southern District of New York interrupted third-party payments by enjoining clearing houses, operators and systems, as well as depositaries, settlement, transfer and trustee paying agents to process payments from Argentina to the creditors who had agreed to Argentina's restructuring offer. In addition to Argentina's argument that the court order violates the country's sovereignty, the ruling also raised serious concerns about the decisions' extraterritorial effect on dollar payments. In 2015, a court in the UK weakened this assertion.[7] After Argentina transferred interest payments destined for exchange bondholders to the Bank of New York Mellon acting as trustee, the bank had to choose between being held in contempt for the violation of an injunction and disregarding its primary duty as trustee. BNY Mellon chose to refrain from making the payment to the exchange bondholders. In a lawsuit brought by the exchange bond creditors claiming payment from BNY Mellon, the UK court decided that UK law governed the trust indenture with BNY Mellon. However, Justice David Richards also held, "[i]t would be quite wrong for this court to make, and I do not make, any comment on such orders as may be appropriate and their effect as a matter of US law" (Justice David Richards in the quoted decision, para. 45). Ultimately, the judge declined to order that the 225 million euros ($257 million) held by the trustee be distributed to the bondholders. Currently, Argentina still has not been able to pay to its creditors holding restructured bonds, and its payment system agents are still complying with the court order and do not provide their services for Argentina's payments to exchange bondholders. The holdout creditors effectively could use a US court injunction against payment-system agents to exert pressure on an otherwise sovereign country.

7 *Knighthead Master Fund LP et al. V. The Bank of New York Mellon*, [2015] EWHC 270 (Ch) (England and Wales High Court (Chancery Division), http://www.bailii.org/ew/cases/EWHC/Ch/2015/270.html.

3.3 CACs 3.0

This prospect worried the US financial community and the US Treasury Department. In 2013, the latter organized a high-level working group with the goal of designing a market-based solution to neutralize the effects of the rulings and address the shortcomings of traditional CACs that exposed Argentina's and Greece's restructurings. The idea was to strengthen and standardize existing aspects of the legal clauses embedded in sovereign bond contracts. To speed up the process and generate buy-in from market participants, the US Treasury decided to delegate the design and marketing of reforms to the ICMA – a private industry standard-setting body whose members include banks, asset managers, and securities issuers and brokers/dealers.[8] The Treasury-ICMA working group consulted with ICMA members, as well as non-member investors, insurers, and market makers. Officials from the Institute of International Finance (IIF), the IMF, and several creditor governments also participated actively (Makoff and Kahn 2015).

In August 2014, the ICMA published *ICMA Standard CACs* and an *ICMA Standard Pari Passu Provision*, new standard provisions that sovereign borrowers can incorporate into their bond contracts going forward (ICMA 2014a,b).[9] To deal with the aggregation problem, the new ICMA CACs – CACs 3.0[10] – include a so-called "single-limb" provision "that will enable bonds to be restructured on the basis of a single vote across all affected instruments, subject to safeguards designed to ensure inter-creditor equity and minimize the risk of sovereign manipulation" (IMF 2014: 1).[11] The new standard *pari passu* provision, for its part, is simply intended to clarify and standardize the meaning of *pari passu* so as to prevent the type of legal interpretation taken by the US federal judge in the Argentina litigation. These new contractual features have already been included in recent bond issuances by Chile, Ethiopia, Kazakhstan, Mexico, Vietnam, and others. Even if these new provisions are widely adopted, however, it could take them over a decade to work their way into the existing debt stock, due to the volume and lengthy maturities of outstanding bonds (Makoff and Kahn 2015).[12]

8 Please browse www.icmagroup.com for more information.

9 In 2015, ICMA published specific model clauses for New York and English law, ICMA. 2015. "New York and English Law Standard CACs, Pari Passu and Creditor Engagement Provisions." May. http://www.icmagroup.org/resources/Sovereign-Debt-Information/.

10 Following the 2003 issuances with CACs, and the EU's two-limb CACs, the ICMA model with a single-limb aggregation feature represents the third generation.

11 The new standard CACs also allow for a "two-limb" voting procedure, enabling differential treatment among creditors.

12 In response to this challenge, Makoff and Kahn (2015) consider ways to hasten this conversion process, which they suggest could be coordinated by the G20.

3.4 The Legal Status of CACs

CACs contained in individual sovereign debt contracts are legally binding within the jurisdiction where the bond is issued. From a contractual and national legal perspective, then, sovereign bond contracts and the CACs contained therein are hard law – they specify legally binding obligations and procedures for the contracting parties. But in terms of international law and the global governance of sovereign debt crises, there is nothing hard or binding about CACs in the sense that sovereign debtors are not obligated to incorporate them in their bonds. The exception to this rule is the Eurozone where, as mentioned above, the introduction of a model CAC has become "mandatory in all new euro area government securities with maturity above 1 year issued on or after 1 January 2013" (ESM Treaty: paragraph 3, article 12).[13] For the majority of the world's sovereign debtors, however, CACs remain little more than standards of best practice. Their use has been endorsed by the G7, the G20, the IMF, the UN, and private sector organizations such as the IIF and the ICMA, but none of these actors has the power or authority to compel states to use CACs or to punish them when they do not. CACs are therefore a fully voluntary, market-based mechanism with which to help overcome the collective action problems that arise during debt restructurings.

3.5 Codes of Conduct

The other main mechanism of sovereign debt governance are codes of conduct – informal rules that outline "best practices" for sovereign lending and repayment. There are two such codes of conduct, the most prominent of which is the *Principles for Stable Capital Flows and Fair Debt Restructuring*, developed under the auspices of the IIF and introduced in 2004 as a sort of transnational public-private partnership (PPP) between sovereign debtors and their private creditors (Ritter 2009). Designed to complement CACs, the purpose of the Principles is to provide an additional soft law mechanism to further promote and guide cooperative relations between sovereign debtors and their private creditors, not just during debt restructurings but in normal times as well. In other words, the Principles aim to promote the prevention as well as resolution of crises through adherence to four broad principles: data and policy transparency, open dialogue and cooperation, good-faith negotiations, and fair treatment of all creditors.[14] More specifically, notes Ritter (2009), "they aim to foster transparency and the timely

13 http://europa.eu/efc/sub_committee/cac/index_en.htm.
14 https://www.iif.com/about.

flow of information between debtors and creditors and to ensure close debtor-creditor dialogue and cooperation to avoid restructuring," and when restructuring becomes inevitable, they seek to "facilitate a voluntary process of debt restructuring based on good faith and ensure the absence of unfair discrimination among affected creditors."

Although the Principles are voluntary and non-binding, sovereign debtors have a market-based incentive to implement them. As Ritter (2009) notes, a key "motivation for sovereign debtors to subscribe to this mechanism is emerging, namely the signaling and reputational effects stemming from commitment and compliance," and that "private creditors and investors play an important role in advancing implementation of the Principles to the extent that they provide sovereign debtors with relevant reputational rewards and penalties" (see also Vojta and Uzan 2003). In other words, deference to the Principles is achieved through reliance on what Tomz (2007) calls the "reputational mechanism," through which compliance is rewarded (and non-compliance punished) vis-à-vis improved (or impaired) access to international capital markets. The Principles were supported by emerging markets borrowers, and are endorsed by major financial institutions, the G10, G20, IMF, and the Paris Club (Ritter 2009; Gelpern 2012).

In 2009, as the Greek crisis was beginning to take shape, UNCTAD launched an initiative with the aim of establishing internationally recognized and widely accepted "principles that promote and reinforce responsible sovereign lending and borrowing practices" (UNCTAD 2012). The initiative culminated in the release of a new code of conduct in 2012, the Principles on Responsible Sovereign Lending and Borrowing (PRSLB) (UNCTAD 2012). While this code of conduct appears to resemble the IIF's Principles in form and intent, it differs from the latter in its more balanced emphasis on the responsibilities of both debtors and creditors and its status as a sort of living document open to stakeholder input and revision. It also presumably differs in the types of incentives it relies on for implementation. It is not clear how the PRSLB can leverage market-based or other material incentives to its advantage; in fact, to the extent that UNCTAD's and the IIF's codes of conduct are competing standards, sovereign debtors may worry that embracing the former will weaken their reputation in capital markets. While the PRSLB have received endorsements from at least 13 countries, it remains to be seen whether this relatively new code of conduct will complement or challenge existing mechanisms, and whether it can become a significant tool for preventing and resolving sovereign debt crises.

Looking at CACs and the two codes of conduct paints a pretty clear picture of the nature of existing mechanisms for sovereign debt management and restructuring – in essence, they are market-based, soft law standards of "best practice."

4 International Financial Standards

Since the creation of the Basel Accord in 1988, the general trend in global financial regulation has been toward the development of non-binding, soft law standards, with a range of public and private standard-setting bodies (SSBs) playing the primary rulemaking role. While the development of standards had been "underway for many years in various areas relevant for the functioning of financial markets" (IMF 1999a: 1), it was not until the late 1990s that the main contours of the international financial standards regime began to take shape. Prompted by a series of large-scale developing and emerging market financial crises (notably the 1994 Mexican financial crisis and the 1997–1998 Asian financial crisis) that were believed to have been caused by inadequate supervision and regulation in crisis countries, there was a strong push among G7 policy makers to strengthen and promote international financial standards (Helleiner 2010). The result was a proliferation of new international standards – including those related to banking supervision, securities regulation, and insurance oversight – and, to coordinate the main actors at the heart of the emerging standards regime, the creation of the Financial Stability Forum (FSF) by the G7 in early 1999. The FSF's unique membership structure brought together representatives from: the finance ministry, central bank, and regulatory authorities of each G7 country (a tripartite structure); several key international organizations including the IMF, World Bank, Bank for International Settlements (BIS), Organization for Economic Cooperation and Development (OECD), the European Central Bank (ECB), the main international SSBs and other groupings (Helleiner 2010).[15]

4.1 The Logic of Standards

Despite the preferences of G7 countries, international financial standards have remained voluntary largely due to developing country resistance to the creation of legally binding rules (Clarke 2014). But the lack of a legal enforcement mechanism does not mean that these standards are completely without "teeth." Many of the standards that are *de jure* voluntary rely on a *de facto* compliance mechanism that operates through market incentives. The market-

15 These included the Basel Committee on Banking Supervision (BCBS), International Association of Insurance Supervisors (IAIS), International Organization of Securities Commissions (IOSCO), International Accounting Standards Board (IASB), Committee on Payment and Settlement Systems (CPSS), and the Committee on the Global Financial System.

oriented logic of standards runs as follows: if countries adopt standards of best practices, they will send positive signals to global financial markets about the strength and stability of their financial systems, the soundness of their regulatory and macroeconomic policy regime, their willingness to play by the rules of the game, and so forth. Having received such positive information, markets will be more willing to invest in countries that adopt financial standards. In sum, countries that want to attract foreign capital – which developing countries almost unanimously do – have an incentive to adopt international financial standards.

This market-oriented logic has guided the IMF's Standards and Codes Initiative – including its Reports on the Observance of Standards and Codes (ROSCs) and its Financial Sector Assessment Program (FSAP) – launched in 1999 alongside the creation of the FSF (Lombardi and Woods 2008). In 2011, the IMF and the World Bank reported that the Initiative was well-received, and that a large number of countries underwent one or more of the 1077 ROSCs performed between 1999 and 2010. Banking supervision standards (176 ROSCs) and accounting and auditing standards (113 ROSCs) were assessed most frequently, and insolvency and creditor rights (42 ROSCs) the least frequently. Regionally, European and American countries had the highest numbers of ROSCs, with countries like Brazil, Chile, Mexico, India, Russia, Turkey, The UK, and Poland receiving more than nine each. Asia had the lowest rate (IMF and World Bank 2011), with countries like Iraq, and Mynmar receiving none at all, and China, Iran, and Vietnam each receiving only one or two. In an early document outlining the market logic of the initiative, the IMF (1999b: 1) stated that "[t]he development and adoption of standards in areas central to the effective operation of domestic and international financial systems holds the promise of better-informed lending and investment decisions, increased accountability of policy makers and better policy making and, ultimately, improved economic performance." As Lombardi and Woods (2008: 720) explain, "the international standards initiative was explicitly designed for the financial markets as an instrument to help private sector agents to improve their allocation decisions." They identified peer pressure, as well as a country's desire politically to be seen as willing to cooperate with the IMF as key transmission mechanisms for the implementation of the standards. While central to the Fund's approach, the market logic of standards goes well beyond the IMF. In fact, Koppel's (2010: 19) exhaustive study of 25 public and private global governance organizations (GGOs) notes that "[e]ven when GGOs have formal tools to compel enforcement, the market mechanisms inducing implementation seem more important."

4.2 The Market Logic of the Sovereign Debt Restructuring Regime

Although not yet considered to be a part of the international financial standards regime, the standards and codes that govern the prevailing market-based approach to sovereign debt restructuring also operate largely according to market mechanisms. For example, the IIF's code of conduct, which prescribes best practices for debtors and creditors engaged in sovereign debt restructuring, relies on the so-called "reputational mechanism" (Eaton and Gersovitz 1981; Eaton et al. 1986; Tomz 2007) to encourage adherence to its principles. As the logic goes, sovereign debtors that adopt and adhere to these best practices send a positive signal to financial markets regarding their willingness to "play by the rules," and this, in turn, is supposed to enhance the country's reputation as a responsible borrower. Debtors that choose not to adopt the IIF's code, by contrast, risk sending the "wrong" signals to markets and, in doing so, undermining their reputation and with it their access to (affordable) international credit.

Although the original version of CACs does not operate according to market logic in quite the same way – markets will not punish debtors for not adopting CACs – they do adhere to a certain market-based rationale. In the context of the early 2000s, when new mechanisms to improve sovereign debt restructuring outcomes were actively being sought, CACs were introduced and mainstreamed, instead of the alternative SDRM, because they did not trump or run contrary to market incentives. In other words, CACs were not embraced because they leveraged the market-oriented logic; they were accepted because they were compatible with it, and because they held the promise of preempting the non-market-based SDRM (Gelpern and Gulati 2004). Although it is too early to tell, the newest standardized CACs 3.0 may actually produce market incentives for sovereign debtors to upgrade their bond contracts. Unlike the original version, CACs 3.0 were developed by market actors in response to a problem that threatened the material interests of the financial sector (especially in New York) as well as the legitimacy of the market-based approach to sovereign debt restructuring. In line with the market-oriented logic of standards, CACs 3.0 could send a reassuring signal to investors that they would not have their asset streams frozen in the event of litigation surrounding a default.

In this vein, recent efforts at the UN level have been geared towards market-friendly soft law rather than the imposition of hard law standards. As already discussed, UNCTAD's PRSLB are not binding, and their effect very much depends on market acceptance (UNCTAD 2012). The latest developments, however, indicate that at least some stakeholders implicitly assume that "regulatory standards" hold a better prospect for sovereign debt restructuring. Recently, UNCTAD published a

Roadmap and Guide for Sovereign Debt Workouts (UNCTAD 2015), wherein UNCTAD articulated principles governing a fair sovereign debt workout mechanism and suggested specific steps towards a more formal restructuring framework. One part of the Roadmap advocates for the establishment of a Debt Workout Institution that would have the duty to coordinate between debtor and creditors, and to decide on disputes if other attempts of dispute resolution fail. As to implementation, UNCTAD suggests to first adopt non-binding soft law instruments, and that the Debt Workout Institution could host a sovereign debt restructuring tribunal only "at a later stage and after accumulating experience with the more informal mechanisms for which it would originally be designed" (UNCTAD 2015). In other words, although UNCTAD suggests a formal mechanism, the Roadmap's first steps are of a non-binding soft law nature. The United Nations General Assembly took the same line when passing a resolution for the creation of a "multilateral legal framework for sovereign debt restructuring." Discussions are ongoing; however, lacking support from countries hosting major financial centers it seems unlikely that the General Assembly will adopt binding regulatory standards in the next step.

As the above discussion indicates, the current soft law, market-based governance of sovereign debt restructuring fits nicely with the prevailing approach to international financial standards. Despite this compatibility, however, there has been little consideration of the potential role the FSB – the focal institution of the financial standards regime – could play in developing, coordinating, and promoting standards and codes for sovereign debt restructuring. The next section sketches out a basic case for FSB involvement in this issue-area.

5 The Case for FSB Governance of Sovereign Debt Restructuring

Beyond the case that can be made for seeing sovereign debt as a financial stability issue, there are a number of reasons for FSB involvement in the governance of sovereign debt restructuring. Three stand out in particular, as they relate to the FSB's comparative regulatory advantage, relative neutrality, and membership composition.

5.1 Comparative Regulatory Advantage

By virtue of its mandate, legal status, and organizational structure, the FSB is well positioned to coordinate and administer a soft law, standards-based regulatory architecture, which is the direction in which debt restructuring processes have moved since the early 2000s.

5.1.1 Mandate

The FSB's mandate is geared toward overseeing and coordinating soft law regulatory standards with an eye to mitigating systemic risk and preserving international financial stability.[16] In addition, it coordinates national regulators in creating strengthened common international standards and in the overall development of their financial regulatory policies. Recent standards address the problem of "too-big-to-fail" or aim at making the derivatives markets safer.[17] In order to promote a "race to the top" among its members, the FSB keeps the "Compendium of Standards," which lists the various economic and financial standards that are internationally accepted as important for sound and stable financial systems.[18] The FSB includes standards in the Compendium that are relevant for a well-functioning financial system, universal in applicability, flexible in implementation, and broadly endorsed. For instance, in the macroeconomic policy area, the FSB includes, among others, the Code of Good Practices on Fiscal Transparency, and the Code of Good Practices on Transparency in Monetary and Financial Policies.[19] Notably, neither the IIF Principles nor UNCTAD's PRSLB form part of the FSB's Compendium. A possible reason for the absence of sovereign debt standards in the Compendium could be that the IIF Principles aim at improving debt restructurings with sovereign debtors in emerging markets and therefore address other, or a sub-group of, constituents than the FSB. As for UNCTAD's relatively young PRSLB, it would be important to get a broad-based buy-in on what constitutes the substantive core of the Principles. The simple adoption by large groups of countries might ultimately dilute the Principles if they were not to actually implement them (Gelpern 2012).

Moreover, the FSB monitors the implementation of rules agreed upon by its members, and oversees a peer review mechanism.[20] Additionally, non-members

16 To this end, the FSB established the Standing Committee on Assessment of Vulnerabilities for identifying and assessing risks and vulnerabilities in the financial system. The Standing Committee publishes reports on global shadow banking and other finance issues that might cause spillover effects for the global economy. See, for instance, FSB (2014).
17 See http://www.financialstabilityboard.org/what-we-do/policy-development/.
18 See http://www.financialstabilityboard.org/what-we-do/about-the-compendium-of-standards/.
19 See http://www.financialstabilityboard.org/what-we-do/about-the-compendium-of-standards/key_standards/.
20 See FSB (2015).

of the FSB also influence the organization's work on financial stability. The FSB has set up six regional consultative groups, through which it reaches out to authorities in 70 other countries and jurisdictions, including a wide range of emerging market and developing economies. Through these groups, the FSB discusses policies with non-members while they are still being formulated and the effects of policies as they are being implemented.[21]

Sovereign debt governance fits nicely within this mandate for at least two reasons. One, sovereign defaults and debt restructurings often trigger cross-border and cross-sectoral financial instability, making them an important source of systemic risk. Therefore, regulating sovereign debt restructuring fits nicely within the FSB's mandate to promote international financial stability. Two, as described above, the main mechanisms that have evolved to facilitate sovereign debt restructuring are of a soft law variety, making them the appropriate types of rules for FSB governance. Yet, while these debt restructuring standards and codes fit within the FSB's soft law framework, they currently suffer from a lack of coordination and complementarity. For example, the two existing codes of conduct are essentially competing standards seeking to occupy the same governance space rather than complementary mechanisms within a coherent overarching framework. The same lack of coordination and complementarity is true of the various institutions or authorities in this issue-area. That there is no primary or central institution governing sovereign defaults and debt restructurings results in a high degree of regime or governance fragmentation (see Biermann et al. 2009). Authority over sovereign debt governance is fragmented in the sense that there are several loosely-connected, partially overlapping sources of authority in this domain, from the IMF and the Paris Club to the IIF and ICMA as well as various UN bodies and even domestic courts in the US. In other words, it is not clear who is or ought to be in charge of setting out the regulatory mechanisms for resolving unsustainable sovereign debt. Among other things, this fragmentation of authority can encourage an unproductive form of "forum shopping," whereby different sets of actors – e.g. developing country debtors, bilateral creditors, and private investors – appeal to different rule-making authorities depending on their interests and perceived prospects of success in a particular organizational venue. More generally, the result is an incoherent, decidedly suboptimal international regime for sovereign debt restructuring.

To minimize this fragmentation, the FSB could serve as the focal institution responsible for overseeing the coordination and further development of regulatory standards for sovereign debt restructuring. In this context, coordinating standards means coordinating the work and activities of the institutions that set

21 See http://www.financialstabilityboard.org/what-we-do/.

them, which falls in line with the FSB's mandate to coordinate "national financial authorities and international standard-setting bodies as they work toward developing strong regulatory, supervisory and other financial sector policies" (FSB website).

5.1.2 Soft Law Status

Unlike formal, treaty-based intergovernmental organizations such as the IMF or World Bank, the FSB was not established via formal international agreement and has no formal standing under international law. Its status as a soft law body, while seen as a weakness in some respects (see Helleiner 2010), can also be viewed as a strength when it comes to sovereign debt governance. In pointing to the distinct advantages of a soft-law approach, some scholars highlight the flexibility and "procedural efficiency" associated with this mode of global governance (Brummer 2011). Others emphasize the significant lowering of costs – namely the "contracting costs" of negotiating and ratifying international agreements and the "sovereignty costs" of relinquishing autonomy or control within a given policy area – typically associated with the creation of formal, treaty-based organizations (Abbott and Snidal 2000). Scholars also emphasize the "advantages of soft law under conditions of uncertainty, where the complexities of an issue and/or the implications of an agreement are not well understood" (Clarke 2014: 203).

These benefits of a soft law framework apply particularly well to the issue of sovereign debt restructuring, for both practical and political reasons. Practically, the high levels of uncertainty surrounding sovereign debt restructuring – for example, uncertainty around whether a country is facing a liquidity or solvency problem, what the systemic spillover effects of a restructuring might be, and even where the next crisis might come from and what it might look like – provide a strong functionalist rationale for a flexible, soft law approach to governance. Politically, a soft law approach also accommodates some of the key concerns powerful actors have had regarding the creation of a statutory debt restructuring mechanism. During the SDRM debate, the largest financial industry associations jointly denounced the idea of a statutory mechanism because they saw it as, among other things, too rigid and inflexible to deal with uncertain and changing circumstances as they evolve. For them, "financial crises [could] only be managed with a market-based approach" (EMCA et al. 2002). At the same time, the US government allegedly viewed the creation of an SDRM as an impingement on its state sovereignty (Setser 2010). Sovereignty concerns may also help to explain the lack of advanced economy support for the UNGA initiative today. The FSB's framework – with its minimal sovereignty costs, maximal flexibility, and overall compatibility with market-based mechanisms – could help quell these important sources of opposition and, in doing so, advance politically acceptable solutions to the problems associated with sovereign debt restructuring.

5.1.3 Organizational Structure

The FSB's broad organizational structure – bringing together "(a) National and regional authorities responsible for maintaining financial stability, namely ministries of finance, central banks, supervisory and regulatory authorities, (b) International financial institutions; and (c) International standard-setting, regulatory, supervisory and central bank bodies" (Art. 5 Financial Stability Board Charter) – is also conducive to the governance of sovereign debt restructurings, which have both cross-border and cross-sectoral systemic implications. In bringing together the G20 countries, the FSB's membership structure is designed to promote cross-border dialogue among representatives from the world's most systemically important economies. At the same time, it is designed to encourage the sharing of information and expertise across sectors by convening domestic-level officials from finance ministries, central banks, and regulatory agencies (as well as international organizations, such as the IMF and SSBs). This unique membership composition is apt to facilitate the type of cross-border and cross-sectoral coordination needed to address issues of sovereign debt restructuring, which affect banking, securities, and even insurance markets at national and international levels. But effectively regulating this multidimensional issue-area depends on more than just open lines of communication; it also requires intimate knowledge of the inner-workings of financial markets and macroeconomic policy among rule-makers. Here, too, the FSB has a distinct advantage. Its unique membership gives it a greater degree of expertise than the IMF or other international organizations over complex financial sector and regulatory issues (Clarke 2014).

In practice, the FSB does not have policy levers to back up its mandate. Instead, the discharge of its mission takes place through "a symbiotic relationship that it tries to nurture among its constituent members" (Lombardi 2011). The FSB facilitates a collective assessment that prompts a set of responses which each member may address differently within the purview of its own mandate. This practice of leaving room for country-specific considerations would considerably facilitate discussions of a framework for sovereign debt restructurings. Historically, countries opposed framework proposals fearing that potential investors might turn away if a country has access to a clear sovereign debt restructuring mechanism, or because they did not want to agree to a mechanism that – in their perception – would have violated their sovereignty. The FSB's practice of country specific implementation would leave it to its constituent members to decide on how to best implement the endorsed policies, and how to preserve investor relations and/or state sovereignty.

Notably, decision-making at the FSB operates under the basis of consensus. The FSB's Plenary does not have a majority voting mechanism, but depends on the unanimity among its members. Even the election of the FSB chair must take place by consensus among all members (Lombardi 2011). The consensus requirement among its broad membership would make it difficult for the FSB to impose hard law measures, such as debt standstills, during sovereign debt restructurings that require speedy decisions. The FSB, however, would be a better-suited candidate to coordinate the review of the implementation of soft law principles among its members as well as foster the development of such standards.

5.2 Relative Neutrality

The FSB also makes sense as an institutional home for sovereign debt governance because it is a relatively neutral organization, yet all of its individual members – whether sovereign debtors, creditor-hosting countries, international financial institutions, or SSBs – have a stake in the creation of more orderly and predictable processes for restructuring sovereign debt. Unlike the IMF, which some have suggested is the appropriate institutional home for a debt restructuring framework, the FSB is not a creditor and, as such, has no economic interest in how individual debt crises are resolved. Indeed, the IMF's role as an international creditor with seniority status is one of the reasons why private creditors and civil society organizations alike have been skeptical of proposals to establish a comprehensive debt restructuring mechanism within the IMF (Dickerson 2004). In search of a more neutral organization, several observers have argued that the UN is an ideal or appropriate venue for the development and administration of sovereign debt restructuring processes (Paulus and Kargman 2008). True, the UN does not have the same conflict of interest that the IMF arguably does. It also enjoys the broad legitimacy of being a universal membership organization, which is something the FSB patently lacks. However, while the UN may be among the best venues to host or oversee a treaty-based arrangement, it is arguably not the best-suited organization to coordinate and further cultivate a standards-based system. Here, for the reasons outlined above, the FSB has distinct advantages. Thus, the combination of the comparative regulatory advantages derived from its mandate, soft law status, and organization structure, on one hand, and its role as a non-creditor – and therefore relatively neutral – organization, on the other, make the FSB a suitable institution for overseeing the coordination and further development of soft law regulatory standards for sovereign debt restructuring.

5.3 A Framework for Collective Action

There is at least one additional reason to believe that the FSB could play a productive role in sovereign debt governance: as a coordinative forum-like institution made up of the world's most systemically important economies, the FSB has the potential to serve as a framework for collective action in an area where it is arguably much needed. In the past, significant collective action problems have complicated the creation of seemingly desirable rules for sovereign debt restructuring. As the historical examples from the 1930s, 1970s, and 2000s show, *inter alia*, the fear of being stigmatized in markets and undermining one's creditworthiness provide strong incentives for sovereign debtors to avoid unilateral actions that upset the status quo. Here, unilateral actions include voicing support for a particular reform initiative. If, however, a significant group of systemically important debtors (and creditor countries, for that matter) introduced reforms in a collective single undertaking, capital markets neither would be able to ignore these debtors nor discriminate amongst them. The FSB provides an appropriate forum for overcoming these collective action challenges. Its membership is expansive enough to represent the systemically important economies in sovereign debt and global finance. Yet the FSB is focused enough – that is, it is not too big or disparate – to render collective decision-making manageable. In sum, due to its comparative regulatory advantage, relative neutrality, and potential as a framework for collective action, the FSB is well suited to play a key, Pareto-improving role in the governance of sovereign debt restructuring.

5.4 FSB's Tasks

The FSB performs five main tasks (Lombardi 2011). The first task is to prepare specialist reports on issues affecting financial stability upon request of certain FSB member country institutions. The second task is to serve as base for a peer review mechanism, which is similar to the peer reviews at the OECD. A continuing review procedure serves to monitor the implementation of international standards and facilitate greater dialogue between FSB members. The third task is to oversee the policy development work of international SSBs and to coordinate the alignment of their activities. The fourth task is to perform an early-warning function, and to identify financial booms or potential systemic financial difficulties. The fifth task is to foster compliance with international prudential standards by all countries and jurisdictions. To this end, the FSB is called to initiate a peer review process vis-à-vis non-cooperative jurisdictions. In sum, the FSB fosters the development and implementation of international standards by fostering coordination across different sectoral and national regulators to promote financial stability.

Accordingly, under the first task, the FSB could, for instance, focus on the implications of sovereign credit default swaps (CDS) for the orderly resolution of severe sovereign debt crises. Insured creditors are less inclined to agree to a disadvantageous deal with the debtor, because they have the fallback option of waiting for a credit event and covering their losses in an ISDA coordinated auction (Brooks et al. 2015). As the argument goes, if a creditor is particularly well insured against default, he may even actively seek to push the debtor into insolvency to cash out with further gains (Guzman and Stiglitz 2014), before the insurance coverage expires.[22] Further, Brooks et al. (2015) describe how such conflicts of interest further incentivize non-cooperation in debt restructuring negotiations, effectively exacerbating the problem of creditors holding out.

Under the second task, the FSB could be given a mandate to oversee peer reviews for sovereign debt restructuring frameworks. Gelpern (2012) suggests that the implementation of UNCTAD's PRSLB first requires securing clear endorsements from key groups of stakeholders including states, civil society groups, and market participants. The FSB, with its diverse membership, could follow this recommendation and facilitate the discussion among its members on how to implement and further develop the PRSLB as well as the IIF's *Principles for Stable Capital Flows and Fair Debt Restructuring,* or a newly-revised set of principles. Subsequently, the FSB could start to oversee peer reviews by which FSB member states would have the possibility to assess whether creditors and sovereigns comply with a given code of conduct. This would play out well with the UNGA's latest Resolution, in which it adopted a set of non-binding debt restructuring principles rather than a full-fledged statutory mechanism.[23] The FSB could endorse these new principles, and initiate a peer review process on member state compliance.

Similar to peer reviews by OECD member states, FSB-led reviews of state compliance with sovereign debt restructuring principles would have no immediate negative consequences for states. The FSB or its member states would not impose any sanctions on a non-compliant member state, but merely publish reports on creditor or debtor states' behavior during or before a sovereign debt crisis. Such

22 Please refer to http://blogs.wsj.com/moneybeat/2015/01/26/how-cds-investors-pushed-caesars-in-restructuring-talks/.

23 See UN General Assembly Resolution A/69/L.84, 10 September 2015.

a holistic assessment would be novel. So far, assessments either touched upon the debtor's approach to sovereign debt restructurings, for instance by pointing out a lack of reforms to create higher debt sustainability,[24] or reports explain why and by which means creditors agreed to cancel debt after negotiations with the debtor.[25] The FSB, representing both the creditor and the debtor perspectives, would be an ideal candidate to oversee and publish more holistic peer reviews on compliance with principles for sovereign debt restructurings, and would thereby contribute to the drafting of specific and concise case studies.

Under the third task, the FSB could leverage on its institutional linkages to anchor new soft law by developing the existing principles into a proper regulatory standard. A process of substantive and technical elaboration over time would be beneficial for the implementation of international standards, like the PRSLB (Gelpern 2012). To start this process of elaboration, a group of experts composed of FSB members could prepare a report on how sovereign debt contracts or debt management practices might better reflect the goals of the Principles. This process should be open, and any reports on the Principles should be publicly available and inviting public comment. Eventually, stakeholders – under the coordination of the FSB – will be able to assess which parts of the Principles should harden into regulatory standards so that national authorities have a clearer guideline in handling sovereign debt issues. The process of elaboration and "hardening" should also be applied to the soft law principles resulting from UNGA discussions regarding a sovereign debt workout mechanism. Since the UNGA preferred to pronounce new Principles on sovereign debt restructurings rather than a statutory debt workout mechanism, the FSB could coordinate the implementation and further development of the principles, and, at a later stage, could get involved in elaborating the Principles into workable regulations. The FSB, moreover, could harmonize the various regulatory efforts being pursued in the US, or the EU, with the aim of ensuring a level playing field on the derivatives markets at the global level.[26]

24 Cf. the IMF's latest debt sustainability assessment for Greece explaining that "if program policies had been implemented as agreed, no further debt relief would have been needed to reach the targets" (IMF 2015).

25 Cf. Zettelmeyer, Trebesch and Gulati (2013) describing creditor interests during the 2012 debt restructuring in Greece.

26 In the US, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, which established a comprehensive framework for regulating the OTC swaps markets. Title VII of the Act authorizes the Securities Exchange Commission ("SEC") to regulate security-based swap dealers and major security-based swap participants. Further, the SEC is called to create a system by which dealers and participants can register with the SEC. The SEC, moreover, enacted Regulation SHO to target naked short-selling of derivatives (for more information see http://www.sec.gov/investor/pubs/regsho.htm). In Europe, the EU adopted a regulation on short

Moreover, the FSB could support its members in fostering harmonization across national legislations. National legislation affecting sovereign debt restructurings is a rare but effective tool to address certain issues, especially in major financial centers. For instance, the UK passed the Debt Relief (Developing Countries) Act[27] in order to prevent holdout creditor litigation against highly indebted and poor debtor countries in UK courts (Brooks and Lombardi 2015). With the Debt Relief Act the UK sought to endorse the IMF's Heavily Indebted Poor Countries (HIPC) Initiative.

In Belgium, the federal legislature passed a statute "Against the Activities of Vulture Funds" that was adopted on 12 July 2015.[28] The statute principally defines the meaning of "illegitimate advantage" (or claim), and orders that recognition and enforcement of relevant foreign judgments or arbitral awards is considered to be contrary to Belgian ordre public international, hence unenforceable. A claim is "illegitimate" if the value at which the creditor bought the claim and the claim's face value, or the amount demanded by the creditor, are patently disproportionate. At least one of the following criteria should be met: (i) the debtor state was close to restructuring its debt at the time the creditor bought the claim, (ii) the claim is brought by an investment company that is located in a tax haven, (iii) the creditor systematically uses court proceedings to enforce (distressed) debt instruments that the creditor had bought previously for this purpose, (iv) the creditor refused to participate in the debtor state's debt restructuring, (v) the creditor abused the debtor state's weak position to negotiate a conspicuously unbalanced payment arrangement, or (vi) full payment of the sums claimed by the creditor would have an unfavorable impact identifiable in the public finances of the creditor state and might compromise the socio-economic development of the debtor state's population.

In addition, Belgium and Luxembourg adopted national laws in response to challenges for sovereign debt restructurings and the protection of clearing houses. After Peru and Nicaragua had restructured their sovereign debt,

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selling and certain aspects of CDS, which came into force on November 1, 2012 (Regulation (EU) No 236/2012, Official Journal of the European Union L 86/1, Mar. 24, 2012). With this regulation, the EU essentially prohibited the buying and selling of sovereign CDS without an underlying bond instrument. To enhance efforts for the prevention of market abuse, the FSB is already active in the field of CDS and added high-level principles for the effective regulation of short-selling to the Compendium of Standards (http://www.financialstabilityboard.org/2009/06/cos_090601/).

27 http://www.legislation.gov.uk/ukpga/2010/22/contents.

28 Doc. 54 1057/001, available in Dutch and French https://www.dekamer.be/flwb/pdf/54/1057/54K1057001.pdf. The statute was published on 11 September 2015, see in Dutch and French http://www.ejustice.just.fgov.be/cgi/article_body.pl?language=fr&pub_date=2015-09-11&numac=2015003318&caller=summary.

holdout creditors filed motions for injunctive relief in a Belgian court seeking to stop Euroclear, a clearing house headquartered in Brussels, from processing certain payments. In order to protect Euroclear, Belgium passed a law that renders unenforceable any (Belgian) court orders that block clearing houses from their duty to process payments.[29] Likewise, Luxembourgian law prohibits the enforcement of an injunction against funds passing through Clearstream, a European clearing house headquartered in Luxembourg and Germany. Article 15 of the Luxembourg Securities Act provides that "neither an attachment of, nor an enforcement against, nor a conservatory measure with respect to accounts to which securities accounts in the securities settlement system are booked are permitted." In the Argentinean *pari passu* saga a US court ordered that agents of international payment systems, such as clearing houses and trustees processing payments to creditors with restructured bonds on behalf of Argentina, must not assist Argentina unless holdout creditors receive ratable payment (see above 3.). Neither the mentioned national laws to protect clearing houses, nor the fact that trust agreements are governed by English law were sufficient to prevent holdout creditors from exercising considerable pressure on a sovereign state. Agents of international payment systems preferred to hold still and not issue payments on behalf of Argentina over being held in contempt for the violation of an injunction issued by a US court. The FSB could take a facilitating role vis-a-vis the efforts of national legislators in major financial centers in addressing sovereign debt issues. It could coordinate its members in discussing, how agents of international payment systems can be protected from being used to exercise pressure on sovereign states. The extraterritorial effects of a court order in the US should not openly contradict the declared purpose of national laws, such as the UK Debt Relief Act, the Belgian law against vulture funds, or the national laws of Belgium and Luxembourg for the protection of clearing houses. In essence, the FSB could help to streamline national legislatures in protecting international payment systems and on how injunctions should – or should not – be implemented against sovereign states.

Under the fourth task, the FSB could detect early warnings for the financial sector, and the potential for international spillovers, from a distressed sovereign debtor. To this end, the FSB relies on a "pooling approach" that builds on assessments of its members, which includes market actors with proximity to financial sector standard setters and regulatory bodies with an insider knowledge about the workings of financial markets (Lombardi 2011). The task of detecting early warnings for the financial sector is mainly conducted by the Standing Committee

29 Article 9 of the Belgian Act of April 28, 1999 implementing the EU Settlement Finality Directive as amended by Article 15 of the Law of November 19, 2004 and by subsequent legislation.

on Assessment of Vulnerabilities. The FSB regularly publishes reports on topics such as global shadow banking or on data gaps involving foreign currency exposure.[30] A potential field of interest in connection with sovereign debt could be to monitor more closely the developments on the sovereign CDS markets. In this connection, the FSB could call on its members to disclose more data on sovereign CDSs to the Bank for International Settlements (BIS). If the BIS published detailed data on the credit rating of sovereign CDSs, or on the regional distribution of sovereign CDS contracts, the FSB would be better-positioned to have its members analyze the data, and publish comprehensive reports on developments in sovereign CDS markets.

Another area of interest for the FSB under the fourth task would be to monitor the effects of court orders against sovereign debtors on payment systems and clearing houses. The order of the US court for injunctive relief against Argentina imposes the risk of contempt sanctions on trustees, securities clearing houses, and payment systems around the world (Gelpern 2013). Such court orders have systemic relevance, as they affect both agents in international payment systems and creditors holding restructured bonds. The FSB should closely monitor and analyze holdout litigation proceedings, and issue timely warning reports before a similar court decision affects the international financial system in a similar way.

Finally, under the fifth task, the FSB could foster compliance with non-cooperative jurisdictions – that is, financial centers, industries or certain categories of market actors which are not in line with a set of internationally-agreed standards. In doing so, the FSB would detect and publicize non-compliance, leading to reputational sanctions. Similar to its reports on global adherence to regulatory and supervisory standards on international cooperation and information exchange,[31] the FSB could publish reports that show how certain sovereign debtors or creditors deviate from internationally accepted sovereign debt restructuring principles. UNCTAD's PRSLB, the IIF's *Principles for Stable Capital Flows and Fair Debt Restructuring*, or the new set of Principles resulting from the consultations at the UNGA level would be more effective if the FSB could support a process to discover creditors and debtors who do not comply with the Principles and describe how their behavior disregards international standards. Table 1 below summarizes the FSB's role in the governance of sovereign debt restructuring.

30 http://www.financialstabilityboard.org/what-we-do/vulnerabilities-assessment/.
31 http://www.financialstabilityboard.org/what-we-do/implementation-monitoring/initiative-on-cooperation-and-information-exchange/.

Table 1: FSB's Role in the Governance of Sovereign Debt Restructuring.

Tasks	Tasks relating to sovereign debt restructuring
1. Prepare specialist reports on issues affecting financial stability upon request of certain FSB member country institutions.	Focus on the implications of sovereign credit default swaps (CDS) for the orderly resolution of severe sovereign debt crises.
2. Serve as base for a peer review mechanism, similar to the peer reviews at the OECD.	Facilitate the discussion among FSB members on how to implement and further develop the PRSLB as well as the IIF's *Principles for Stable Capital Flows and Fair Debt Restructuring*, or a newly-revised set of principles. Oversee peer reviews on compliance with sovereign debt restructuring agreed-upon Principles. Endorse the new UNGA Principles, and initiate a peer review process on member state compliance.
3. Oversee the policy development work of international SSBs and to coordinate the alignment of their activities.	Connect international standard setters to anchor new soft law by developing the existing debt restructuring principles into a proper regulatory standard. Further discuss the extraterritorial effects of court decisions in sovereign debt cases on foreign legal systems. Facilitate coordination of national legislatures and regulators in their efforts to protect clearing houses, trustees, and other agents of international payment systems from being sued by holdout creditors. Help to streamline national regulation on the implementation of foreign injunctions against sovereign states.
4. Perform an early-warning function, and identify financial booms or potential systemic financial difficulties.	Call on its members to disclose more data on sovereign CDS. Facilitate coordination of members' data analysis, and publish comprehensive reports on developments on the sovereign CDS markets. Monitor holdout litigation against sovereigns who restructured their debt, and the effects of court decisions on international payment systems and clearing houses.
5. Foster compliance with international prudential standards by all countries and jurisdictions.	Publish reports identifying sovereign debtors or creditors who deviate from internationally accepted sovereign debt restructuring principles.

6 Conclusion

This paper has reviewed the evolving discussion regarding sovereign debt restructurings. Many attempts have been made to introduce a sovereign debt workout mechanism with similar features to private parties' bankruptcy proceedings. So far, however, the actual approach towards sovereign debt restructurings has only been changed when the market allowed such changes. This was the case for the IMF's SDRM proposal, which was abandoned when the market, along with key emerging market borrowers, chose instead to introduce CACs.

Historically, soft law instruments have proven more effective at producing change in sensitive areas of financial markets. The FSB's mandate reflects this reality, as it has been charged with coordinating soft law regulatory standards, mitigating systemic risk and ultimately preserving international financial stability. Accordingly, in connection with sovereign debt restructuring, the FSB could serve as the focal institution responsible for overseeing the coordination and further development of soft law regulatory standards.

UNCTAD and the IIF have established soft law principles for sovereign debt restructurings, and have encouraged their stakeholders to adhere to these principles. However, a closer monitoring mechanism for these principles provided by an objective third-party institution is missing. In this vein, the FSB could serve as a base for overseeing and reporting on the fairness of sovereign debt workouts with regard to these principles. Regardless of whether the work at the UN level only leads to the further development of international soft law standards for sovereign debt restructurings, or whether UN stakeholders create a more formal framework – as initially intended by the UNGA in its sovereign debt resolution – the FSB should play an important role in implementing the resulting standards. There will always be a need for monitoring regulatory standards to assess their effectiveness and developing these standards to address weaknesses and loopholes. Given its soft law nature and its experience with implementing delicate financial reforms, the FSB is uniquely equipped to help in the design and governance of a more effective sovereign debt restructuring regime.

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