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**GOVERNING SOVEREIGN DEBT RESTRUCTURING  
THROUGH REGULATORY STANDARDS  
THE FINANCIAL STABILITY BOARD AND SOVEREIGN DEBT**

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# The Issue I

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- Sovereign debt crises in Greece, Argentina, Ukraine
- Case to case approach--low level of confidence that restructuring brings a sustainable solution
- International community lacks an agreed-upon method or set of tools to resolve sovereign debt crises

# The Issue II

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- Traditional dichotomy being between contractual and statutory approaches
- Instead strengthen the emerging soft law regime
- Financial Stability Board's role: important but underutilized
- FSB as the focal institution responsible for overseeing the coordination and further development of soft law regulatory standards for sovereign debt restructuring

# The Long Search for a Hard Law Mechanism I

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- 1933: Mexican foreign minister, Jose Manuel Puig - establish international organizations responsible for debt negotiations and agreements
- WW2: Initial blueprints for Bretton Woods institutions – no default without approval of the IMF
- 1978: UNCTAD and the G77 call for an independent forum for sovereign debt restructurings
- Early 2000s: IMF proposes to establish the SDRM - supermajority, aggregate binding voting mechanism for creditors
- 2014: U.N. General Assembly Resolution for the creation of a “multilateral legal framework for sovereign debt restructuring”

# The Long Search for a Hard Law Mechanism II

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- All proposals to create a statutory mechanism were ultimately abandoned

Reasons:

- Creditors concerned about voluntary defaults
- Creditors fear enhanced bargaining position of sovereign debtors
- Debtors fear that wrong signal to foreign investors
- Debtors concerned about their sovereignty
- The institution controlling the mechanism must be neutral (IMF arguably has creditor bias)
- CACs as alternative

# Codes of Conduct I

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Institute of International Finance (2004):

Principles for Stable Capital Flows and Fair Debt Restructuring

- Promote cooperative relations between sovereign debtors and private creditors
- Already before debt stress arises
- Data and policy transparency, open dialogue and cooperation, good-faith negotiations, fair treatment of all creditors
- Reputational mechanism: commitment and compliance have reputational effects for debtor's access to international financial markets

# Codes of Conduct II

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UNCTAD (2012):

Principles on Responsible Sovereign Lending and Borrowing

- Responsibilities of both debtors and creditors
- Living document open to stakeholder input and revision
- So far, 13 countries endorsed UNCTAD Principles

# International Financial Standards

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- Late 1990s Asian financial crisis caused by inadequate supervision and regulation
- New international standards and cooperation between national and international standard setters for (i) banking supervision, (ii) securities regulation, and (iii) insurance oversight
- IMF's Standards and Codes Initiative (1999) – including Reports on the Observance of Standards and Codes (ROSCs) and its Financial Sector Assessment Program (FSAP)
- Market mechanisms inducing implementation seem more important than formal tools to force compliance
- Similar for sovereign debt: soft law and market based approach
- IIF Principles, UNCTAD Principles, CACs are all voluntary

# FSB Governance of Sovereign Debt Restructuring I

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- Financial Stability Forum by the G7 in 1999
- FSB created to overview the work of standard-setters, to monitor the implementation of the rules agreed upon by its members, to mitigate systemic risk, and to preserve international financial stability
- Sovereign debt governance fits nicely within this mandate: (i) sovereign debt issues often trigger cross-border and cross-sectoral financial instability (source of systemic risk), (ii) the main mechanisms to facilitate sovereign debt restructuring are soft law (appropriate types of rules for FSB)

# FSB Governance of Sovereign Debt Restructuring II

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- In a governance domain that is relatively fragmented btw 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
- Although there remains room for treaty-based organizations like the UN and the IMF to develop a hard law approach to sovereign debt restructuring, the FSB is best positioned to strengthen and oversee the soft law approach, which currently prevails as the modus operandi of the current debt restructuring framework

# FSB Nature and Organization

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- Soft law nature: FSB was not established via formal international agreement and has no formal standing under international law
- Given its setup, not necessary to relinquish sovereignty within a given policy area (no “sovereignty costs”)
- Active through analysis and enforcement of member states – leaves room for country-specific considerations
- Broad membership: G20 plus financial center countries, (i) National ministries of finance, central banks, supervisory and regulatory authorities, (ii) international financial institutions, and (iii) International standard-setting, regulatory, supervisory and central bank bodies
- No majority voting mechanism – FSB depends on the unanimity among its members

# FSB's Tasks I

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- The rationale for FSB involvement focuses on:
  - ❖ on the institution's comparative regulatory advantage,
  - ❖ its relative neutrality (no senior creditor status),
  - ❖ and its potential as a framework for collective action (systemic, focused membership)

# FSB's Tasks II

Traditional FSB Tasks	Potential 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.	Oversee peer reviews on compliance with sovereign debt restructuring agreed-upon Principles.
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. Harmonize the various regulatory efforts being pursued by national legislatures and regulators.

# FSB's Tasks III

<b>Traditional FSB Tasks</b>	<b>Potential Tasks Relating to Sovereign Debt Restructuring</b>
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. Coordinate members' data analysis, and publish comprehensive reports on developments on the sovereign CDS markets
5. Foster compliance with international prudential standards by all countries and jurisdictions.	Publish reports that show how certain sovereign debtors or creditors deviate from internationally accepted sovereign debt restructuring Principles.

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