The Sovereign Debt Forum: A Snapshot

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The **Sovereign Debt forum (SDF)** proposal aims to reduce the impediments that sovereign debtors and their creditors face in proactively handling sovereign debt crises and to preserve value for stakeholders.

Context

The 2008 financial crisis and developments in Europe and the United States since then have highlighted three major gaps in our current informal, market-based approach to resolving sovereign debt crises:

- **First,** as the International Monetary Fund (IMF) noted in April 2013, sovereigns tend to deal with debt crises too late and restructure too little, in part because the *ex ante* costs of treating distressed debt remain too high. Creditors and debtors need to be brought together on a proactive basis to deal with incipient sovereign financing problems and agree on a credible plan to restore a sovereign to growth and liquidity;
- **Second,** once a crisis has taken hold, a reasonably automatic way to provide a country with sufficient breathing room is needed to assess whether it faces a problem of illiquidity or insolvency, and to design appropriate action to minimize the *in medias res* costs of a crisis; and
- **Third,** the failure of around half of the collective action clauses (CACs) in the 2012 Greek debt exchange and the recent rulings in NML *v.* Argentina underscore that further efforts are needed to reduce the *ex post* costs of crisis resolution by ensuring that a restructuring can be made effective once its terms have been agreed.

Between the rejection of the IMF's Sovereign Debt Restructuring Mechanism (SDRM) proposal in 2003 and the 2008 financial crisis, research and discussion to improve our processes for dealing with sovereign debt crises waned. These issues are too critical to allow this to happen again. Since 2003, CACs have been widely inserted in more sovereign bond series, but CACs do not provide a framework for dealing with a crisis: they simply help prevent an already agreed restructuring from being derailed by a small minority of creditors. We need pragmatic ways to improve on the status quo that do not require changes to the Articles of Agreement of the IMF, negotiation of an international treaty, or sweeping statutory changes—for which there is little political appetite.

The SDF proposal

The SDF proposal has been crafted to produce better outcomes from sovereign financial crises without requiring a heavy reform of institutions or legal frameworks. The SDF would have two major features: first, it would provide a centre for research on continuous improvement of the processes for assisting financially distressed sovereigns; and second, it would create a venue for ongoing, proactive discussions between a comprehensive membership of debtors, creditors and other stakeholders to reach early understandings on treating specific sovereign crises.

Operations. The SDF's ongoing discussions would be overlaid on existing institutions and processes: it would not compete with or replace any of them. No stakeholder would give up power or leverage. The SDF's regular *tours d'horizon* would share information and review financing and debt sustainability in all countries, based on input from the IMF Article IV process and analysis by other stakeholders. SDF staff would not generate competing country studies, but would instead seek to reconcile data and various evaluations to assist stakeholders in finding common ground on the challenges faced by sovereigns. In the event of specific sovereign distress, the SDF's discussions could segue smoothly to early interactive discussion of concrete measures for crisis prevention, adjustment, and debt treatment. Understandings on shared action would be recorded in agreed minutes on a presumption that all stakeholders would implement them on a bilateral basis. The agreed minutes would not have legal standing.

Value added. Through its research functions, the SDF would support ongoing efforts to improve our treatment of sovereign financial problems. At the same time, the SDF's continuous discussion of country prospects would dampen the stigma faced by any individual country or creditor that initiates talks on a specific case of distress. The SDF would ensure faster action on sovereign crises and more proactive engagement of all stakeholders in designing credible solutions. In particular, creditors would be brought into the discussion on the appropriate balance between adjustment and restructuring at a much earlier stage, which should deepen their engagement, increase their ownership of agreed crisis response measures and minimize holdouts. Participation in the SDF is incentive compatible: as IMF research has shown, earlier treatment of sovereign crises both reduces the likelihood that a liquidity crisis will morph into a full solvency crisis and minimizes costs for most stakeholders.

Staff. The SDF would be run by a lean team of professionals and headed by an expert of international stature. Although staff members could be seconded from stakeholders, the SDF would always aim for independence in its operations.

Creation. The SDF could be incorporated as a nonprofit institution in an appropriate jurisdiction. Alternatively, it could be housed within an existing international institution such as the Bank for International Settlements (BIS) or IMF, or within a national public body, so long as the SDF's location does not compromise its perceived independence.

Financing. The SDF would need secure, multi-year financing which could come from contributions from members to a trust fund; gifts toward an initial endowment that would generate sustained annual income; annual tax-advantaged fundraising efforts; and/or membership fees.

Simple. As some have noted, the SDF is an 'embarrassingly simple' concept. Indeed, this speaks to its *raison d'être*: simple initiatives such as the SDF, could substantially improve the outcomes from sovereign financial crises.

Links with other proposals

The SDF would complement efforts currently underway to create automatic standstills for distressed sovereigns by encouraging issuance of state contingent debt (i.e., 'sovereign cocos'). It would also complement initiatives to improve the model language for bond contracts to provide for more effective one-step aggregation amongst creditors. Each of these proposals could be implemented independently, but each of them would be stronger if implemented together. None of them would require an internationally-agreed treaty or common statutory measures across countries. They could be instituted unilaterally by a single stakeholder or by a small group of like-minded parties.

For additional details, please consult www.cigionline.org:

- Gitlin, Richard and Brett House (2014). "A Blueprint for a Sovereign Debt Forum." CIGI Paper, No. 27. Waterloo: CIGI.
- Gitln, Richard and Brett House (2013). **"**The Sovereign Debt Forum: Expanding Our Tool Kit for Handling Sovereign Crises." CIGI Policy Brief, No. 28. Waterloo: CIGI.