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A Soft Law Mechanism for Sovereign Debt Restructuring

Based on the UN Principles

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- Sovereign lending markets are not working well. The current non-system for sovereign debt restructuring remains fraught with perverse incentives, which in turn lead to destructive and inequitable outcomes.
- The United Nations General Assembly approved in September 2015 nine principles that should guide sovereign debt restructuring processes.
- This brief analyzes the usefulness of those principles and discusses how to move reforms forward.

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Contents

1. Introduction*

The ultimate goal of sovereign debt restructuring is to restore the sustainability of public debt *with high probability.*[1] But this is not happening. Since 1970, more than half of the restructuring episodes with private creditors were followed by another restructuring or default within five years[2] — evidence inconsistent with any sensible definition of »restoration of sustainability of public debt with a high probability.« This evidence suggests that relief for distressed debtors is often insufficient for achieving the main goal of a restructuring, delaying the recovery from recessions or depressions, with large negative social consequences.[3]

The lack of a statutory regime for dealing with distressed sovereign debt makes sovereign debt crises resolution a complex process — marked by inefficiencies and inequities that take multiple forms.[4] The current *non-system* is characterized by bargaining based on decentralized and non-binding market-based instruments centered on collective action clauses and competing codes of conduct. The IMF often plays the role of the facilitator in this process of bargaining between a distressed debtor and its creditors.[5] But it has not always been successful in ensuring that restructuring needs are addressed in a timely way — indeed, it has often failed; and as we have already noted, even when restructuring processes have ultimately been carried out, they have often not been deep enough.[6] Overall, the current non-system does not respect priority agreements or resolve inter-creditor inequities, address debtor-in-possession financing, or address adequately such ex-ante concerns as ensuring that creditors have sufficient incentives to lend under the right terms, or borrowers have sufficient incentives for prudential behavior.[7]

The gaps in the legal architecture create perverse incentives for legal arbitrage and work against cooperation. These gaps have led to the emergence and growth of so-called vulture funds, hedge funds whose business model is based on exploiting the deficiencies in the rule of law that they helped shape.[8] They specialize in attacking countries in debt crises. The modus operandi consist in first buying distressed debt at bargain prices in secondary markets, generally issued under New York law, and then suing the issuer claiming full payment — full principal and full interest, including punitive interest[9] and compensation for risks that they did not take. Once they get a favorable ruling, if the country refuses to pay according to the ruling's terms, they employ tough tactics.[10] This kind of behavior has been on the increase over the past decade: While in the 1980s only about 5 per cent of debt restructurings were accompanied by legal disputes, this figure increased to almost 50 per cent in 2010 (see Schumacher, Trebesch, and Enderlein, 2014).

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1. Public debt is sustainable with *high probability* when in *most* of the possible economic scenarios its repayment does not require a sequence of future borrowings that is unbounded. A sustainable debt path may entail *some* probability of default (i. e. the debt could only be sustained with unbounded borrowing), reflected, of course, in an interest rate that is higher than the safe rate of return. If there is a very high rate of interest, it would normally reflect that, in the judgment of the market, there is a significant probability of default. On the other hand, an outside expert group might conclude that there is a high probability of default even if the market risk premium is small; markets are sometimes »irrationally exuberant«.

2. See Guzman (2016a), Guzman and Stiglitz (2016b).

3. In the presence of cross-border spillovers, the delay is also costly for the countries that have economic relations with the distressed debtor. See Orszag and Stiglitz (2002).

4. Economic theory shows that, in the presence of macroeconomic externalities, markets will not resolve restructuring processes efficiently. See Miller and Stiglitz (1999, 2010).

5. The bargaining process is itself an indication of the absence of perfect competition. Especially when there is bargaining with imperfect and asymmetric information, both the outcomes and the process may be inefficient.

6. The IMF Independent Evaluation Office has pointed out serious flaws in the IMF role in the European crisis (IEO of IMF, 2016). The IMF forecasts of countries in distress are often flawed, overestimating the speed of recoveries of countries in recessions (Guzman and Heymann, 2015), despite the fact that the non-linearities of fiscal multipliers recognized by the literature (Auerbach and Gorodnichencko, 2012; Blanchard and Leigh, 2013) are indications that the programs of fiscal adjustment should be expected to pose difficulties for recovery.

7. See Guzman and Stiglitz (2016a) for a more extensive analysis.

8. A prime example is the elimination of the defense of champerty for debt purchases or assignments of a value exceeding 500,000 US dollars by the New York state legislature in 2004. Previously, champerty prohibited purchasing debt in default with the intention of suing the issuer (see Blackman and Mukhi, 2010).

9. Under New York law, the pre-judgment interest rate is 9 per cent. It was fixed in 1981, when the annual inflation rate in the US was 8.9 per cent, and it has not been modified since despite the significant fall in inflation. Such an interest rate on pre-judgment claims is more punitive than compensatory. Besides, vulture funds that buy defaulted debt may receive interest payments at this rate before there is a sentence even for periods between the default and the purchasing date, a period of time during which they did not hold the bonds. This is what happened in the dispute between Argentina and the vulture funds following the default of 2001 (see Cruces and Samples, 2016; Guzman, 2016b).

10. In the dispute with Argentina that followed the default of 2001, for instance, they managed to seize an iconic ship belonging to the country, they attempted unsuccessfully to seize deposits of the Central Bank of Argentina in the Federal Reserve Bank of New York, they funded a variety of advertisements intended to put pressure on Argentina's government to satisfy their demands, and they even supported the creation of a lobbying taskforce (American Task Force Argentina) that hired former high-profile government officials as lobbyists.

Outcomes are alarming. The vultures' strategies are bringing exorbitant returns that result in severe inter-creditor inequities, which in turn aggravate a moral hazard problem that threatens the possibility of finalizing a process of sovereign debt restructuring — as it happened in the recent case of Argentina, for instance. In light of recent events good faith creditors are learning that holdout behavior pays off. In Argentina's recent saga with the vulture funds in the US courts (where the vultures were led by NML Capital, a subsidiary of the New York based hedge fund Elliott Management), it wasn't even necessary to be a litigant in order to receive the same treatment the courts awarded to the vultures: the courts ordered the country to treat non-litigant holdout creditors in the same terms obtained by litigant vulture funds. Why, therefore, would good faith creditors be willing to cooperate on a restructuring process with a distressed debtor, which would probably include a large discount, if they could simply follow the lead of a vulture fund and get returns that could be in the order of hundreds or even thousands per cent higher? The main problem with the aggregation of these individually »rational« actions is that, if a sufficiently large number of bondholders follow the same strategy, debt restructuring would become impossible to finalize. The case of Republic of Argentina v. NML Capital intensified an already long-running debate over the need for systemic reforms that involved academics, practitioners, multinational institutions, and civil society.[11]

On the one hand, the International Capital Market Association (ICMA), with the support and endorsement of the IMF, suggested reforms to the sovereign debt contractual language in order to prevent situations like the one Argentina experienced with the vultures. The suggested new terms include a formula for aggregating collective action clauses (see ICMA, 2014; IMF, 2016; Gelpern, Heller, and Setser, 2016). Some countries are already issuing debt using this new language. Although the new terms are a sign of progress, they are unlikely to be sufficient to resolve fundamental problems currently faced in restructuring processes (see Guzman and Stiglitz, 2016a).

On the other hand, the United Nations took the lead in the efforts that aim to create a statutory mechanism for sovereign debt restructuring, as first reflected in the UN GA Resolution 68/304 passed in September 2014 and later in UN GA Resolution 69/319 passed in September 2015. The latter resolution approved a set of nine principles that should serve as the basis for restructuring processes — sovereignty, good faith, transparency, impartiality, equitable treatment of creditors, sovereign immunity, legitimacy, sustainability, and majority restructuring (henceforth the »UN Principles«).

The UN has laid out steps in the right direction. Although in the short term the creation of a multinational statutory framework for debt crises resolution does not seem to be feasible, the UN principles provide a valuable basis for the next stages of the process. This article analyzes the usefulness of those principles. Section 2 discusses how the principles could help in improving the resolution of sovereign debt crises. Section 3 explores a possible way forward along the lines of an incremental approach.

2. The Usefulness of the UN Principles

Of the 176 Member States that voted on UN GA Resolution 68/304 of September 2014, 124 voted in favor, 41 abstained, and 11 voted against. The group of countries that abstained or voted against the resolution included mostly advanced economies. A year later, of the 183 countries that voted on UN GA Resolution 69/319 adopting the UN principles, 136 countries voted in favor, 41 abstained, and only 6 countries voted against. The latter group included the US and the UK, the two major jurisdictions for sovereign debt issuances by emerging economies, as well as Canada, Germany, Israel, and Japan.

The UN principles have not been respected in many of the recent restructurings.[12] Respect for them would resolve most of the deficiencies observed in recent restructuring processes.

Sovereignty

The principle of **sovereignty** recognizes that the sovereign must have the right to decide its policies consistent with the objectives of the State, including the right to restructure its debt. Violating the right of a sovereign to

11. The Report of the International Commission of Experts of the International Monetary and Financial System appointed by the president of the General Assembly of the United Nations had pointed out that the approaches to sovereign debt restructuring were flawed, and that improvement was urgently needed to avoid further efficiency losses and inequitable results (Stiglitz et al., 2010).

12. See the Appendix for the full text of the UN principles.

initiate a restructuring process obviously may result in the maintenance of debt levels that are not sustainable — but denies the sovereign any clear path out of the unsustainable debt. The result is that the economic situation of the distressed country is aggravated. Argentina's case is again illustrative of these tensions: Had Argentina's creditors realized the disadvantageous outcome (relative to the vultures) implied by the recent US Court Decision, they might not have settled and the country would have not recovered.[13] Argentina would have been in limbo, neither being able to repay nor to restructure its debts without inflicting unconscionable pain on its citizens — and even with such pain, repaying on its debt would not have been possible.[14]

Good Faith

The principle of **good faith** imposes a duty on the sovereign debtor and its creditors to negotiate when the sovereign's debt position becomes unsustainable. It states that negotiations in good faith must aim to reestablish debt sustainability. The literature offers guidance for determining the practical meaning of this principle for creditors: It entails a duty to participate in debt workout negotiations, a duty to stipulate equitable restructuring terms, a duty not to jeopardize the outcome of good faith negotiations by a negative vote, and a moratorium on holdout litigation seeking to extract preferential treatment (Goldmann, 2016). The principle also entails the protection of legitimate expectations, the prohibition of the abuse of rights, and the prevention of unjustified advantage from unlawful acts (Kolb, 2006).[15] The anti-vulture legislation adopted by Belgium in 2015 provides practical guidance for codifying some aspects of this principle: Holdout behavior could be classified as abusive when the debt was acquired in default or at price reflecting a large difference between the nominal and the market price, and the bondholders' claim payments are disproportionate with respect to what could be reasonably expected at the time of purchase, as reflected in market prices and the state of the sovereign debtor's economy.

There are other aspects of good faith: creditors who purchase instruments that include a compensation for risk cannot in good faith bargain to receive treatment as if the lending were risk-free. They should accept that offsetting the high returns when things go well are the low returns when they do not (cf. Goldman, 2016; Guzman and Stiglitz, 2016a).

The principle must also be codified for the debtor side. A debtor acting in good faith in a restructuring process should negotiate with the goal of achieving a level of debt relief that ensures the recovery of sustainability with high probability, but no more.[16] However, such a level of relief is hard to calculate, because it depends on assumptions about how the debtor's economic performance will depend on the terms of the restructuring, as well as about how it will depend on other relevant factors. In this sense, good faith requires transparency, as it should be clear for the stakeholders involved what are the underlying assumptions that lead to the computation of a specific level of debt relief that ensures the recovery of sustainability with high probability, thus making the debtor's negotiating stance consistent with the principle of good faith.

Argentina's case again illustrates how the domestic courts' lack of understanding of sovereign debt restructuring processes may lead to confusions concerning the meaning of this principle, which in turn can harm the ultimate goals of a restructuring process. In Argentina's dispute with the vulture funds, the Second Circuit defined the country as a »uniquely recalcitrant« debtor,[17] that is, a debtor that didn't act in good faith. But the Court did not cite any element to prove that the restructuring terms proposed by Argentina in the exchanges of

13. The remarkable recovery in the end created the resources to pay large returns on GDP indexed bonds to the exchange bondholders, which led to an ex-post haircut significantly lower than the initial haircut.

14. Similarly, Greece was in effect forced in 2015 to sign on to an agreement entailing a further dose of austerity — which exacerbated its already deep depression — without any clear path to debt restructuring. Germany insisted that there be no debt restructuring, though Greece's public debt was considered to be unsustainable with high probability by almost every analyst, including the IMF. See Varoufakis (2016).

15. While, for economists, some of these terms are fraught with ambiguities, the terms must come to take on relatively well-defined meanings as the principle is applied. It should be obvious that the demands of the vultures were inconsistent with many of these principles. For instance, while NML Capital could have claimed that, in Argentina's case, it was legitimate to expect to be paid in full, since that had happened on other occasions (as in the case of Elliott Associates' victory over Peru in 1998), a well-defined meaning of the concept could entail that the expectation of receiving full payment on a risky promise that has already been broken (as is the case with a defaulted bond), and when the market price of the bond reflects a very low probability of full repayment, is unreasonable and therefore illegitimate.

16. For instance, a debt relief of 100 per cent would obviously recover debt sustainability, but such a write-down would be larger than what distressed sovereigns need to recover sustainability with high probability.

17. See the Second Circuit Decision of August 23, 2013, www.shearman.com/~/media/Files/Services/Argentine-Sovereign-Debt/2013/Arg33_NML_Second_Circuit_Decision.pdf, page 23 (last accessed on 22 September 2016).

2005 and 2010 were abusive, in the sense of aiming at a level of debt relief larger than what would restore sustainability with high probability.[18] Even in the absence of a multinational formal framework for sovereign debt restructuring, a proper codification of this principle could also provide guidance to domestic courts.

Transparency

The principle of **transparency** is also frequently violated. Sovereign credit default swaps (SCDS) can give rise to perverse incentives for those at the negotiating table who hold them, since they may benefit from non-cooperative behavior that leads to a default. Transparent negotiations require disclosure of any potential conflict of incentives that could undermine the outcome of a restructuring process — and this necessitates disclosure of CDS positions. The opaqueness of SCDS markets makes it impossible to know what the incentives of the bargaining parties are in a restructuring process. And non-aligned incentives in this context could lead to inefficient delays. Clearly, bargaining in good faith requires transparency.

SCDS markets have experienced large growth over the past decades. The drafting and interpretation of SCDS contracts are the responsibility of the International Swaps and Derivatives Association (ISDA). Remarkably, those sitting in judgment on the interpretation of a particular contract evidently can do so even when they and/or their firms may be conflicted. Despite the multiple potential conflicts of incentives associated with SCDSs that can undermine restructuring process, these contracts receive certain preferential treatment under securities and commodities regulations and bankruptcy law. ISDA has managed to secure exemptions and preferential treatment through its influence on domestic legislation (see Partnoy, 2002, and Gelpern and Gulati, 2012, for an extended discussion). The principle of transparency also requires the disclosure of restructuring terms applicable to all external and domestic creditor groups (Gelpern, 2016).

Impartiality

The principle of **impartiality** restricts the set of institutions that could host a mechanism for sovereign debt restructuring. Institutions that have a biased representation of the stakeholders involved or are creditors themselves are not suitable hosts for such a mechanism. Judge Griesa's rulings in favor of the vulture funds in Republic of Argentina v. NML Capital violate the principle of **equitable treatment of creditors**. The case involved a situation in which good faith creditors received a discount of about two thirds (see Cruces and Trebesch, 2013), while the vulture fund NML Capital that paid on average 28 cents on the dollar over its declared purchases (done when the country was in a situation of distress, either a few months before the default or after the default, or even after the country had reached a restructuring agreement with 76.15 per cent of the creditors) got returns of approximately 1,270 per cent (see Guzman, 2016b).[19]

It is worth noting that equitable treatment does not necessarily mean identical treatment. Different creditors may acquire debt instruments with different characteristics associated with different risk exposure. There may be justifications for treating different creditors differently — for instance, it could be justifiable to give seniority status to creditors that lend into arrears, helping the distressed debtor to continue the provision of essential services or to run countercyclical macroeconomic policies at the time they are most needed.

Sovereign Immunity

The principle of **sovereign immunity** is one of the most critical principles: it implies that the validity of any sovereign debt contract is constrained by the principle of international law that no country can renounce its sovereign immunity, just as no person can sell himself into slavery. This principle also sets a limit to the extent to which one democratic government can bind its successors. The

18. A common mistake is to evaluate good faith based on a comparison between the level of relief pursued by the distressed debtor and the debt write-downs of other restructuring experiences. But such a criterion is flawed if the situation of the country differs from the sample it is being compared to, or if the sample of other experiences includes a large fraction of episodes where the restructuring process was not effective to restore debt sustainability. Implementing this criterion can create an unintended inertia: the norm that gets established perpetuates itself, no matter how unreasonable. The right comparison for assessing good faith is between the level of relief that the distressed country pursues and the level of relief that would restore sustainability with high probability.

19. NML Capital paid prices that were as low as 10 per cent of the face value for some of the bonds. For instance, the price in secondary markets of the series »Global Bonds, U.S. dollar 11.375 % due 2017«on December 5, 2008, when NML bought bonds of that series, was 10 cents on the dollar; it was 11 cents on the dollar for the purchases of the same series made on January 2, 2009; 10.5 cents on the dollar for purchases of the series »Global Bonds, U.S. dollar 12.25 % due 2018« made on December 10, 2008; 17.5 cents on the dollar for purchases of the same series made on November 5 and 11 of the same year. See Guzman (2016b) for an extensive description of the case.

principle does not rule out the possibility of issuing debt under foreign law, but it places limits on the reach of foreign law, reaffirming the limitations of foreign jurisdictions in sovereign debt restructuring processes.

Legitimacy

There are many aspects of the **legitimacy** of a debt restructuring — it obviously requires impartiality on the part of any party serving as mediator/arbitrator and it requires transparency. Indeed, any restructuring that violates any of the other principles could arguably be viewed as lacking legitimacy. But there are other elements: A debt restructuring conducted under force of arms would lack legitimacy, but so too would one conducted under the threat of economic sanctions, as in the case of Judge Griesa's ruling that effectively precluded Argentina from accessing international credit markets. Thus, Argentina's 2016 debt restructuring arguably lacks legitimacy on these grounds. Any debt restructuring that resulted in the country violating its constitution or the UN Declaration of Human Rights would also lack legitimacy.[20]

Sustainability

Restoring **sustainability** is the primary goal of a sovereign debt restructuring process. The enunciation of the UN sustainability principle recognizes that the relevant stakeholders in a restructuring process are not only the formal, but also the informal creditors (those that do not have formal debt contracts with the sovereign, but towards whom the sovereign has obligations, such as pensioners and workers). The restoration of sustainability must not only balance fairly the rights of foreign and formal creditors but also those of other claimants, and promote sustained and *inclusive* development. Standard approaches, such as that followed by the IMF, have generally ignored this broader perspective, as attention has been focused mostly on formal financial claimants.[21]

Majority Restructuring

Finally, the principle of **majority restructuring** will help to impede holdout strategies such as the ones successfully pursued by vulture funds. There has been progress over the last two years in the elaboration and adoption of contractual language for more robust debt instruments (see ICMA, 2014; Gelpern, Heller, and Setser, 2016; Gelpern, 2016). Although the principle of majority restructuring per se will not rectify all of the deficiencies we observe in sovereign debt restructuring, and although there are ambiguities in aggregating across creditor classes, as we have noted earlier, it is a necessary complement to the other principles.

One country, Argentina, has already adopted the principles. Bolivia's lower house has also passed them. A few months after Argentina adopted them, the country reached a deal with vulture funds and other holdout bondholders that implied the already described inequitable treatment of creditors. Had the country not reached a deal, it would have been impeded from accessing international credit markets. Given its desire to return to international capital markets and the ruling by the U. S. District Court for the Southern District of New York, the country had no choice but to ignore one or more of the UN principles. In the current international financial landscape — where countries issue debt under foreign jurisdictions and the domestic legislation of the jurisdictions in question does not adopt the UN principles, and where the judiciaries in some of these countries do not respect these principles — it is likely that one or more of the principles will be violated in future sovereign debt restructurings. Governments should bear this in mind when borrowing in such jurisdictions.[22]

The adoption of the UN principles contributes to a positive norm setting process. Even if domestic legislations do not adopt them, local courts might follow them as guidance when they interpret and apply the law in reference to disputes related to sovereign debt. Such legislation is also desirable because general principles of law are sources of international law. States need to comply with them as a matter of international law — or at least

20. The United Nations Commission on International Trade Law (UNCITRAL) Guide recommends that any insolvency law »require(s) the disclosure of a conflict of interest, a lack of independence or circumstances that may lead to a conflict of interest or lack of independence« and also that this obligation »continue throughout the insolvency proceedings.« (UNCITRAL Guide, Recommendations 116 and 117).

21. See Bohoslavsky and Goldmann (2016) for a more extensive discussion. Note that Chapter 9 of the US Bankruptcy Code, pertaining to the bankruptcy of public authorities, does make many of these distinctions. See, e. g. Stiglitz (2010).

22. However, political economy concerns mean that such borrowing is likely to continue, if countries can get access to credit in such markets on more favorable terms than they could elsewhere: it is in the interests of both short-sighted creditors and politicians to focus on the short-run benefits, ignoring these long-run costs. See Guzman and Stiglitz (2016a).

they should do so (Goldmann, 2016). There is still a long road ahead in the process of norm setting, and there are possible reforms based on the UN principles that could allow countries to use them as an effective tool. The next section discusses a possible way forward.

3. The Road Ahead

The proposals for sovereign debt restructuring should be evaluated in terms of their ability to ensure the recovery of debt sustainability and whether they respect the UN principles. The contractual approach will not, we believe, fully address this concern satisfactorily.[23] The statutory approach could do so, but it seems to be politically unfeasible at the current juncture. This is an unfortunate situation, especially considering that the current state of the global economy puts several countries at risk of debt unsustainability in the short term.[24] The natural question is what can be done to improve matters soon.

Our proposal for the immediate next steps is to continue efforts to establish a *soft law regime* — an incremental approach that builds on the UN principles and can be complemented by contractual improvements. Soft law has the potential to create a healthier environment for debtors and creditors. It relies on social norms and market acceptance, rather than on legal forces, to induce compliance. This incremental approach inspired the 2015 UN Conference on Trade and Development (UNCTAD) Roadmap and Guide, and was followed by the UN GA in the resolution that adopted the UN principles. It enjoys the support of many academics (see bibliography section) and also of UNCTAD, which, although it recognizes that a multinational legal framework remains the only truly effective and fair solution, fully supports the continuation of efforts to build a soft law regime and regards it as the most constructive and sustainable approach under the current circumstances (see Blankenburg and Kozul-Wright, 2016).

A soft law instrument that codifies the UN principles for practical purposes could serve as a guide for domestic legislation. The codification of the principles might remind courts of the big picture in a sovereign debt restructuring process, possibly mitigating biases towards narrower interpretations of debt contracts. The institution hosting the soft law regime could maintain a registry of recalcitrant holdout bondholders and their parent companies. The registry could serve as a guide for domestic and international courts when they have to decide whether bondholders violated the principle of good faith. It could also host a comprehensive, searchable public database of past restructurings, including financial and legal terms, the treatment of public, private, domestic and foreign claims, and any underlying assumptions used for achieving a restructuring plan.

The institution could create its own debt sustainability analysis (DSA) framework, stating general principles for debt sustainability assessments (respecting the UN GA enunciation of the sustainability principle). It would encourage cooperation among the stakeholders involved in order to achieve a level of relief that respects their sustainability assessments and satisfies the other UN principles. In a process of sovereign debt restructuring initiated by the sovereign, the competent institution would first produce a preliminary DSA and transmit it to the government for a response. The government would be required to disclose information and data necessary for the assessment and to respond to the DSA. The preliminary DSA and the government's response would next be made public to the creditors, other international institutions, and the general public, all of whom would have an opportunity for comment. After a reasonable time period, the institution would publish a final DSA taking into account the government's response and public comment. The final DSA would give reasons that justify the determination made and would indicate possible disagreement with the government, international institutions, or creditors' committees.

The statements of the institution would not be enforceable, but could be used as a legitimate guide for the stakeholders involved (especially for domestic courts) on what is sensible practice in a process of debt restructuring. We believe that these reforms can mitigate the deficiencies that are currently leading to inefficient and inequitable restructuring outcomes.

23. The key point is that under the contractual approach, there is still scope for a judge not well versed in principles of international law and the economics of sovereign debt restructuring to adopt inappropriate interpretations of key terms in the debt contract — as Judge Griesa made so abundantly clear. Although there is no way to prevent similar rulings within the statutory approach, the fact that the judges in such cases would presumably be familiar at least with the issues of international sovereign debt restructurings would make such rulings less likely. The soft law approach described below provides, in effect, further safeguards.

24. See Reinhart (2016).

Appendix: The UN Principles[25]

1. A sovereign State has the right, in the exercise of its discretion, to design its macroeconomic policy, including restructuring its sovereign debt, which should not be frustrated or impeded by any abusive measures. Restructuring should be done as the last resort, preserving at the outset creditors' rights.

2. Good faith by both the sovereign debtor and all its creditors would entail their engagement in constructive sovereign debt restructuring workout negotiations and other stages of the process with the aim of a prompt and durable re-establishment of debt sustainability and debt servicing, as well as achieving the support of a critical mass of creditors through a constructive dialogue regarding the restructuring terms.

3. Transparency should be promoted in order to enhance the accountability of the actors concerned, which can be achieved through the timely sharing of both data and processes related to sovereign debt workouts.

4. Impartiality requires that all institutions and actors involved in sovereign debt restructuring workouts, including at the regional level, in accordance with their respective mandates, enjoy independence and refrain from exercising any undue influence over the process and other stakeholders or engaging in actions that would give rise to conflicts of interest or corruption, or both.

5. Equitable treatment imposes on States the duty to refrain from arbitrarily discriminating among creditors, unless a different treatment is justified under the law, is reasonable and is correlated to the characteristics of the credit, guaranteeing intercreditor equality, discussed among all creditors. Creditors have the right to receive the same proportionate treatment in accordance with their credit and its characteristics. No creditors or creditor groups should be excluded *ex ante* from the sovereign debt restructuring process.

6. Sovereign immunity from jurisdiction and execution regarding sovereign debt restructurings is a right of States before foreign domestic courts and exceptions should be restrictively interpreted.

7. Legitimacy entails that the establishment of institutions and the operations related to sovereign debt restructuring workouts respect requirements of inclusiveness and the rule of law, at all levels. The terms and conditions of the original contracts should remain valid until such time as they are modified by a restructuring agreement.

8. Sustainability implies that sovereign debt restructuring workouts are completed in a timely and efficient manner and lead to a stable debt situation in the debtor State, preserving at the outset creditors' rights while promoting sustained and inclusive economic growth and sustainable development, minimizing economic and social costs, guaranteeing the stability of the international financial system and respecting human rights.

9. Majority restructuring implies that sovereign debt restructuring agreements that are approved by a qualified majority of the creditors of a State are not to be affected, jeopardized or otherwise impeded by other States or a non-representative minority of creditors, who must respect the decisions adopted by the majority of the creditors. States should be encouraged to include collective action clauses in their sovereign debt to be issued.

25. Cf. Chairperson Summary, United Nations Ad hoc Committee on Sovereign Debt Restructuring Processes, Third working session, 24 July of 2015; available at: http://unctad.org/meetings/en/SessionalDocuments/gds_sd_2015-07-27-28_report_en.pdf (last accessed on 22 September 2016).

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Notes on the Literature

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