
Centre for International
Governance Innovation

Conference Report – Toronto, Canada, February 28, 2017

The Model Law Approach: How Ontario Could Lead the World in Providing Certainty and Fairness in Sovereign Debt Restructuring

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CIGI Masthead

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For media enquiries, please contact communications@cigionline.org.

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67 Erb Street West
Waterloo, ON, Canada N2L 6C2
www.cigionline.org

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About CIGI

We are the Centre for International Governance Innovation: an independent, non-partisan think tank with an objective and uniquely global perspective. Our research, opinions and public voice make a difference in today's world by bringing clarity and innovative thinking to global policy making. By working across disciplines and in partnership with the best peers and experts, we are the benchmark for influential research and trusted analysis.

Our research programs focus on governance of the global economy, global security and politics, and international law in collaboration with a range of strategic partners and support from the Government of Canada, the Government of Ontario, as well as founder Jim Balsillie.

À propos du CIGI

Au Centre pour l'innovation dans la gouvernance internationale (CIGI), nous formons un groupe de réflexion indépendant et non partisan qui formule des points de vue objectifs dont la portée est notamment mondiale. Nos recherches, nos avis et l'opinion publique ont des effets réels sur le monde d'aujourd'hui en apportant autant de la clarté qu'une réflexion novatrice dans l'élaboration des politiques à l'échelle internationale. En raison des travaux accomplis en collaboration et en partenariat avec des pairs et des spécialistes interdisciplinaires des plus compétents, nous sommes devenus une référence grâce à l'influence de nos recherches et à la fiabilité de nos analyses.

Nos programmes de recherche ont trait à la gouvernance dans les domaines suivants : l'économie mondiale, la sécurité et les politiques mondiales, et le droit international, et nous les exécutons avec la collaboration de nombreux partenaires stratégiques et le soutien des gouvernements du Canada et de l'Ontario ainsi que du fondateur du CIGI, Jim Balsillie.

About the International Law Research Program

The International Law Research Program (ILRP) at the Centre for International Governance Innovation is an integrated multidisciplinary research program that provides leading academics, government and private sector legal experts, as well as students from Canada and abroad, with the opportunity to contribute to advancements in international law.

The ILRP strives to be the world's leading international law research program, with recognized impact on how international law is brought to bear on significant global issues. The program's mission is to connect knowledge, policy and practice to build the international law framework — the globalized rule of law — to support international governance of the future. Its founding belief is that better international governance, including a strengthened international law framework, can improve the lives of people everywhere, increase prosperity, ensure global sustainability, address inequality, safeguard human rights and promote a more secure world.

The ILRP focuses on the areas of international law that are most important to global innovation, prosperity and sustainability: international economic law, international intellectual property law and international environmental law. In its research, the ILRP is attentive to the emerging interactions between international and transnational law, Indigenous law and constitutional law.

About the Authors

Maziar Peihani is a post-doctoral fellow with CIGI's International Law Research Program (ILRP). Maziar's research at CIGI is focused on international financial law, including sovereign debt resolution. Specifically, he assesses the legal and regulatory dimensions of the reform initiatives currently unfolding in international sovereign debt markets. In addition, Maziar works on the legitimacy of the global governance regime of banking and the legal aspects of cross-border crisis management and bank resolution. Prior to joining CIGI, Maziar was a post-doctoral fellow at the National University of Singapore in the Centre for Banking and Finance Law. Maziar has a Ph.D. in law from the University of British Columbia.

Kim Jensen is an articling student at CIGI, providing assistance to in-house counsel on a range of legal matters and research support to the ILRP. Kim received her law degree from Thompson Rivers University in Kamloops, British Columbia, in April 2016. Prior to law school, Kim completed a bachelor of commerce with a major in international business management.

Executive Summary

A half-day round table meeting brought together individuals representing academia, government, financial institutions, the legal profession and civil society. Their purpose was to discuss sovereign debt crises and the possibility of Ontario taking a leading role in providing certainty and fairness in sovereign debt restructuring for countries around the world that are facing debt crises. The main theme was the feasibility of implementing a model law in Ontario that could become the choice of law for sovereign debt contracts.

Existing sovereign debt restructuring regimes are insufficient to deal with important challenges that have recently emerged in sovereign debt restructuring. The model law, if implemented, would create a new and improved regime. Advantages of the model-law regime include more certain and fair restructuring for sovereign debt, no requirement for multilateral action and creation of an oversight body. Despite these advantages, it remains necessary to satisfy federal and provincial authorities that the model law is an attractive opportunity. Further study will be undertaken to complete a cost-benefit analysis for implementation in Ontario, meet with appropriate federal and provincial authorities, and establish partnerships with countries that issue debt and may wish to do so under Ontario law.

Introduction

In a round table meeting convened by the International Law Research Program (ILRP) of the Centre for International Governance Innovation (CIGI), a group of policy leaders and experts came together on February 28, 2017, to discuss sovereign debt crises and explore how Ontario could lead the world in providing certainty and fairness in sovereign debt restructuring. The half-day round table discussion was organized around three sessions, all held under the Chatham House Rule.¹

Important challenges that have recently emerged in the sovereign debt world sparked the topic of the round table. An international sovereign bankruptcy regime remains politically infeasible, and the prospects for establishing a comprehensive treaty on sovereign debt seem even more bleak. As illustrated by the Argentinian and Greek debt crises, holdout creditors continue to try to exact preferential treatment, causing disruption for other stakeholders. Contractual reforms remain limited and unable to prevent such disruptive litigation. Against this background, the round table aimed to provide an opportunity to discuss a proposed Sovereign Debt Restructuring Model Law,² a novel governance initiative that seeks to address many of the unresolved sovereign debt issues that continue to haunt sovereign debtors and their creditors. The starting proposition was that the model law provides Canada — and in particular the province of Ontario, where capital markets are centred — with a unique opportunity to lead the way out of the sovereign debt impasse.

Session I: Overview of Recent Developments in Sovereign Debt

The substantive discussion of the round table commenced with the observation that while the public debate on sovereign debt predates Bretton Woods, the world still lacks a multilateral regime to deal with sovereign defaults. Conscious of existing political realities, recent efforts to improve the current regime have remained largely sectoral or regional, departing from a contractual or soft-law premise. Some noted that the time is not yet ripe for an international sovereign bankruptcy regime. They thought the best way forward was to reinforce contractual reforms, namely collective action clauses (CACs), and search for statutory measures such as the model law, which does not require a multilateral or treaty system. At the same time, the academic and policy communities should continue working toward a comprehensive multilateral sovereign debt regime, so that the appropriate

¹ Under the Chatham House Rule, those present, including media, “are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed.” For a full explanation of the Chatham House Rule, see: www.chathamhouse.org/about-us/chathamhouse-rule.

² Steven L Schwarcz, “Sovereign Debt Restructuring: A Model-Law Approach” (2015) 6:2 J Globalization & Dev 343; Steven L Schwarcz, “A Model-Law Approach to Restructuring Unsustainable Sovereign Debt” CIGI, CIGI Policy Brief No 64, 21 August 2015 [Schwarcz, “Model-Law Approach”].

mechanism can be established when and if there is a political appetite for multilateral reform.

Participants noted the recent sovereign debt episodes, the Greek crisis in particular. The Greek 2012 debt exchange represented the largest debt restructuring in the history of sovereign defaults. The program amounted to a €200-billion debt exchange and €30-billion debt buyback, allowing for €106-billion debt relief — equivalent to 55 percent of Greek GDP. The Greek sovereign debt crisis is, however, far from over. In 2016, Greek public debt stood at nearly €325 billion, or 184 percent of Greek GDP, and is on an explosive and potentially unsustainable path to reach 275 percent of GDP by 2060. To address the Greek debt issues, the Eurogroup (Eurozone finance ministers) has agreed to extend the maturity of the European Financial Stability Facility loans to Greece from 28 years to 32.5 years and to waive step-up interest rates. It is also willing to use interest rate swaps to help Greece hedge against the risk of higher interest rates and to make new resources available to finance the Greek economy. The International Monetary Fund (IMF), however, has remained skeptical, considering the Eurogroup's proposed measures to be insufficient. The IMF, stressing the need for major debt relief, is expected to complete the second review of the Greek debt program in the coming months and will then decide whether to contribute to the program.

The discussion then moved on to the IMF's role in sovereign debt restructuring. The IMF's role was considered under two broad categories: inter-creditor coordination and financing. Regarding the first category, the IMF has sought to perform a quasi-surrogate role in negotiations "in the shadow of the courthouse." Following the failure of its proposal for the establishment of the Sovereign Debt Restructuring Mechanism (SDRM), the IMF has focused its efforts on voluntary contractual reforms. The most prominent example is the new collective action clauses (CACs 2.0), promulgated by the International Capital Market Association (ICMA), which the IMF has been strongly promoting since their introduction in 2014.

In terms of financing, the IMF's basic position has been that private capital dwarfs the official sector flows. The original policy was to limit IMF access to countries with unsustainable debt dynamics. This meant that the IMF would not lend money without adequate safeguards to ensure repayment, including policy adjustments by the member country in question. The Greek debt crisis came to

test this policy. While the IMF could not determine if Greek debt was sustainable, a refusal to lend was feared to create a contagion risk for the global economy. Another important change came in the late 1990s, when the IMF lent money to countries that were in arrears to their creditors. Rules were then developed to require such countries to work in good faith with their creditors to achieve a solution.

The ongoing Greek debt crisis is likely to test this policy as well. One important complication is the multiplicity of creditors with preferred creditor status. The IMF is no longer the only official sector creditor, and Greece also has to engage with European official sector creditors, such as the European Stability Mechanism. Thus, whether the Greek government can negotiate in good faith with multiple creditors seeking to preserve their preferred creditor status remains to be seen.

The United Nations' work on sovereign debt was the last issue discussed in this first session. Recent holdout litigation and the disruptions it has caused in the restructuring process have created significant concerns for developing countries. Such concerns led the United Nations Conference on Trade and Development to establish an ad hoc group on sovereign debt, and the UN General Assembly passed a 2015 resolution on Basic Principles on Sovereign Debt Restructuring Processes.³ The UN resolution calls for the establishment of principles such as legitimacy, impartiality and good faith. These principles are broad, open to interpretation and should be implemented in accordance with national policies. They can be characterized as soft law, meaning that they complement and support concrete reform proposals such as the model law. They seek to guide the restructuring process, striking a balance between creditors' rights and sovereign rights. The principle of impartiality was highlighted in the Canadian context as favouring Toronto, a neutral jurisdiction within which creditors and debtors can work cooperatively and in good faith to achieve balanced solutions in debt workouts.

³ *Basic Principles on Sovereign Debt Restructuring Processes*, GA Res 69/319, UNGAOR, 69th Sess, UN Doc A/RES/69/319 (2015).

Session II: Sovereign Debt Restructuring Model Law and Opportunities for Canadian Leadership

The discussion in this session proceeded from two threshold questions: why do countries face debt problems; and why are such problems important and a cause of concern for other countries? With respect to the first question, it was noted that, similar to corporations, countries may face debt issues for exogenous reasons that are simply beyond their control. It is therefore wrong to stigmatize sovereign debt, assuming that public mismanagement of finances always creates it. Regarding the second question, attention was drawn to the devastating social and financial effects of sovereign debt crises. On the social side, sovereign debt crises can seriously affect the lives of ordinary people in the borrowing nation. On the financial side, sovereign debt problems can create systemic risk for the entire global financial system, also hampering the ability of other countries to raise money on debt markets.

While the social and economic consequences of sovereign debt crises have been visible for many years, the international norms for addressing sovereign debt issues have remained quite underdeveloped. Collective action problems, created prominently through the actions of holdout creditors who buy bonds at a deep discount but insist on the full repayment of their claims, continue to undermine debt restructurings. While CACs have sought to address collective action problems through incorporating aggregate voting into sovereign bond contracts, they have had limited success. For instance, if a bond contract contains the early version of CACs (CACs 1.0), holdouts can often quite easily block the restructuring process by obtaining a large enough position in a single series of bonds. The new CACs (CACs 2.0) introduced by ICMA have sought to address this problem by introducing aggregate voting. Many sovereign bond contracts, however, still lack CACs 2.0; in addition, CACs do not cover other forms of sovereign debt such as syndicated loans.

The Model Law on Sovereign Debt Restructuring, first proposed by CIGI Senior Fellow Steven

Schwarzc, ⁴ seeks to work in tandem with existing international initiatives, such as CACs and the UN principles on sovereign lending and borrowing, to address such problems. Its provisions have been drafted with significant high-level input from leading sovereign debt scholars and practitioners to ensure its legal congruence and precision. In addition to its robust aggregation features, which are meant to address collective action problems, the model law offers novel solutions such as:

- preferred creditor status for debtor-in-possession lenders that enables the sovereign to raise money on debt markets (provided that creditors have been given notice and the opportunity to block new lending if the amount is too high or its terms are inappropriate);
- a neutral supervisory authority to oversee and discipline the restructuring process; and
- an arbitration mechanism to settle any disputes arising between the parties.

Importantly, the model law does not require any concerted multilateral action. It can become law with only one jurisdiction adopting it. It was noted that this characteristic of the model law provides an important leadership opportunity for Canada and Ontario. Adopting the model law would seize first-mover advantage, gaining significant influence over the development of international norms on sovereign debt. In this respect, the model-law initiative closely resembles the Model Law on International Commercial Arbitration (1985) adopted by the United Nations Commission on International Trade Law (UNCITRAL).⁵ Canada and its provinces were the first jurisdictions to adopt the UNCITRAL model law and many countries followed. Today, that model law has been adopted by 104 jurisdictions.

The reluctance of major sovereign debt jurisdictions, such as New York and London, to reform their laws governing sovereign debt contracts was noted as a factor that further enhances the leadership opportunity for Ontario. While smaller than those of New York and London, the capital markets in Toronto are considered large and deep enough to attract sovereign borrowers. Canada

⁴ Schwarzc, "Model-Law Approach", *supra* note 2.

⁵ UNCITRAL, "Status of UNCITRAL Model Law on International Commercial Arbitration (1985), with amendments as adopted in 2006", online: <www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1985Model_arbitration_status.html>.

is politically stable and has a stellar reputation for the rule of law and an independent judiciary. Furthermore, there is ample experience with issuing and documentation of sovereign debt. Federal and Ontario bonds are predominantly issued under Ontario law and benefit from the legal infrastructure available in the province. In addition, the contracting parties can choose Ontario law to govern their transaction, regardless of where the debt is issued. Finally, it was noted that Canada was an early advocate for sovereign debt reform at the international level and supported the IMF's SDRM proposal. Canada can, therefore, demonstrate that it can do better than New York and London in solving sovereign debt crises.

Session III: Panel Discussion on Model Law and Canadian Leadership

The last session focused more specifically on the model law in the Canadian context, exploring its costs and benefits, as well as the constitutional and financial issues that could arise if Ontario were to adopt the law. It was argued that the Province of Ontario has the constitutional authority to adopt the model law, although complementary federal legislation would be necessary, as well as a practical matter, whether legally essential or not. The province's authority is based on its property and civil rights jurisdiction under the Constitution, and federal jurisdiction is based on its powers with respect to bankruptcy and insolvency. A consensus emerged among the participants that the best way forward was for the province to take the initiative on the model law and to engage with the federal government to enact complementary legislation. Having both levels of government acting together would guarantee the successful implementation of the initiative and provide sovereign borrowers and creditors with full legal certainty to have the debt governed by Ontario law.

Another important theme of the discussion was how to get the financial community interested in the initiative. It was argued that a liquidity premium might be necessary as a sweetener to persuade market participants to invest in and trade sovereign bonds governed by Ontario law. An analogy was made with the Islamic financial instruments known

as sukuku, which included a liquidity premium when they were first offered on the market. This premium was reduced and finally disappeared as the information gap about these instruments gradually closed. Some participants, however, drew attention to the recent experience with issuing the CACs 2.0 bonds. Contrary to the speculation that investors would demand a higher price for such bonds, the market's reaction was smooth, with no impact on pricing whatsoever. A similar experience occurred when Mexico issued bonds under the first iteration of CACs in the early 2000s. The experience with CACs then led to the following point about the importance of signalling and issuing the bonds in good times. As long as the sovereign issuer is in sound financial condition, with no looming questions about its debt sustainability, issuing debt under Ontario law should not, in principle, affect the pricing. The model law can be an even more attractive option than CACs, since it includes provisions for the supervision of the restructuring process and the settlement of disputes through arbitration. Such provisions provide creditors with greater confidence that their legal rights will be reasonably protected at the forum and they will receive a fair remedy in case of default or disputes.

The discussion then delved into the question of whether the province would face any costs or adverse consequences for adopting the model law. Two potential areas of concern were identified: the impact of the model law on the province's debt, and reputational concerns associated with sovereign defaults. Attention was drawn to the fact that Ontario law is the law of choice for the province's debt. The province is therefore self-interested and sensitive to any legislative changes that would impact its public finances. It was argued that there would be little downside or risk for the province, since by adopting the model law it would offer a legal solution to the outside world, especially those low-income and developing economies that have been haunted by recent holdout episodes. Ontario law in this respect is no different from New York law or English law. While these laws are frequently used to govern sovereign debt contracts, they have never raised any doubt about New York's or the United Kingdom's public finances. In addition, the model law will only apply to future issuances and should not, in principle, affect Ontario's outstanding debt stock, unless the legislature were to expressly choose otherwise. Furthermore, there is currently no concern about the credit rating or debt sustainability of the province, and hence no

reason to believe that the adoption of the model law would send a negative signal to the market.

Another possible concern discussed by the participants was the potential negative impact of future sovereign defaults on Toronto's image as a global financial centre. It was pointed out that the markets would have no reason to blame Ontario law for a sovereign default, just as they have not in the past blamed English law or New York law for sovereign defaults governed by their law. A sovereign default should not, therefore, pose any reputational risks to the province's financial or legal reputation.

Finally, the participants discussed the work plan for taking the initiative forward. Two key issues were highlighted. First, CIGI needs to further engage with key stakeholders in the province, in particular the Ontario Ministry of Finance and the Toronto Financial Services Alliance (whose representatives were unable to attend the round table). It would also be helpful to establish a working group to study further the model law in a Canadian context, including the relevant constitutional and drafting issues, and outline a road map for putting the initiative into action. Second, partnerships need to be established with countries that might be interested in issuing debt under Ontario law. Such issuances would signal to the market that Ontario law can be an alternative to New York and English law. Both sovereign borrowers and creditors would then know that they can benefit from the favourable legal and financial infrastructure available in the province.

Agenda

February 28, 2017

11:30 a.m. – 5:00 p.m.

Four Seasons Hotel, 60 Yorkville Avenue, Toronto, Canada M4W 0A4

- 11:30–12:00 p.m. Registration (Lunch is available)
- 12:00–12:15 p.m. Welcome, introduction, expectations of the round table — Oonagh Fitzgerald
- 12:15–1:15 p.m. Overview of Recent Developments in Sovereign Debt — Domenico Lombardi, James Haley, Miranda Xafa, Gregory Makoff, Odette Lienau
- The burden of unsustainable sovereign debt
 - Obstacles to timely restructuring
 - Sovereign debt crises in Argentina and Eurozone
 - Recent US court rulings on holdout creditors
- 1:15–2:45 p.m. Sovereign Debt Restructuring Model Law and Opportunities for Canadian Leadership — Steven Schwarcz, Mark Jewett
- Insufficiency of contractual reform and infeasibility of statutory approach
 - How model law can help with existing uncertainty and collective action problems
 - Model law’s promise for Ontario
- 2:45–3:00 p.m. Health Break
- 3:00–4:30 p.m. Panel Discussion on Model Law and Canadian Leadership — Oonagh Fitzgerald, Mark Jewett
- Exploring legal and political feasibility
 - Advancing Toronto’s position as a global financial centre
 - Constitutional jurisdiction and complementary federal legislation
 - Next policy steps
- 4:30–5:00 p.m. Wrap-up: Where to go from here
- 5:00–6:00 p.m. Reception

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