

Richard A. Conn, Jr. Keynote Address to United Nations (Transcript) April 28, 2015

We have invited Mr. Richard Conn, who is here today with us to be our keynote speaker this morning.

I would like to give you some background for Mr. Conn, I shall do this in English. He is Managing Partner of Innovative Partners LLC, an emerging company, a private investment firm as well as of International Group LLC, an international advisory firm focusing upon Russia and Ukraine. He advised the Yeltsin government on legal/political restructuring and co-authored Colliers Labor Law and the Bankruptcy Code. He lectures at the Columbia University's Harriman Institute of Russian, Eurasian and East European Studies regarding Russia, as well as at INET and of the Columbia's SIPA Center on Global Economic Governance, respecting their initiatives to establish a worldwide sovereign debt restructuring framework.

Mr. Conn practiced international corporate law and litigation. As an equity partner with a law firm Latham and Watkins, he founded the firm's Moscow office in 1992 and served as president of the Moscow based Foreign Bar Association living in Moscow during 1992 to 1995 and 2003 to 2007. He regularly consults with a World Bank, members of Congress and the administration regarding CIS related issues. He served on the board of directors of the US Russia Business Council and co-chaired a joint initiative with the American Chamber of Commerce to facilitate Russian accession to the WTO.

In 2010 Mr. Conn ran for the presidency of the World Chess Federation on an international tickets held by the 24th champion, Anatoly Karpov. With the support of the 13 World Champion Garry Kasparov and is an avid chess player (that's useful here.) He is fluent in Russian and Spanish. So, Mr. Conn thank you very much and welcome everyone.

Our subject today is the creation of a framework for sovereign debt.

Thank you very much, Mr. Chairman, for that kind introduction. And thanks for inviting me to speak here today to all of you. I'd also like to take a moment to thank, Todd and particularly Richard Kozol-Wright. And some of the folks associated with INET, Martin Guzman and Joe Stiglitz for their roles in facilitating my speaking with you today. It is of course a great honor and pleasure to address such a distinguished conference, made up of UN member states delegates. Our subject today is the creation of a framework for sovereign debt restructuring, which I may on occasion referred to as SDR. And when I say

a framework I mean of course some sort of a convention or statute presumably to be adopted by the the UN that would affect in some positive manner how restructurings take place.

Agreeing upon a framework would, if done properly, facilitate the interaction among private and public parties to sovereignty sovereign debt transactions, and in my view, would be a really

good thing to do.

I can see by the attendance today that many of the developing developed countries ~~xx~~Excuse me, do not at this moment agree with that, since they're not attending. But I hope you'll see as I cover the subject and that they'll agree eventually, that there are ways to address this issue that could bring us together and actually be productive both for the developing countries and the developed countries.

I'm going to try to show you why that is.

I want this to be as much fun as possible and as clear as possible, which may shock you given our subject today. But, actually, I think this is a very straightforward issue and one that we can all relate to, once we get through some of the terminology. The presentation today is going to be boiled down to four very simple parts. It should give you an overview, if I do my job right, that will assist you over the next several days of this conference and over the next several months of your work by providing a good overall picture of what's involved in sovereign debt restructuring what the key issues are and some different ways you may want to approach them.

(Referring to Outline on Projected Slides)

So, the first discussion point will be the Catalyst.

The second point will be Key Questions to address.

The third will be a proposed framework. (I'm actually going to let you have target practice by throwing out some proposed framework concepts.)

And finally, I'll end with concluding thoughts which we'll touch on some issues that are a little different than had been raised to date in the restructuring debate.

Overview

But first let me start with a very simple overview of what we're talking about. And for many of you who are familiar with sovereign debt, this will be a little bit basic, but it's important for us all to be on the same page.

While the terms are very fancy sovereign debt restructuring as you all know, is really nothing more than countries borrowing money, and then, reaching a point where they need to pay it back and are having difficulty doing that. In this respect, it's not much different than a simple contract that you may enter into say to borrow money for a car. We've all gone through that. You go to the bank you get money there are documents executed, and you're simply agreeing to pay back that money with a certain interest rate, at a certain time,

Very simple. The difference if you want to think of it in one light is that in the context of your car loan.

if you do not pay it back, the lender (the bank in that instance) has the right to take your car and sell it to be repaid. In the sovereign debt context, these are unsecured loans. So we have a different type of problem because if countries do not repay, you're facing a situation where there is no collateral that can be sold at that moment to pay back those who had lent the money, which in the case of sovereign debt tends to be private parties and public market participants.

Restructurings are privately negotiated deals.

You're involving the holders of bonds, people who have lent money, and those who have borrowed the money (the countries that have taken it.) I also think it's important to realize that as of today there is no mechanism in place that brings together all of the parties to sovereign debt restructurings to allow conversations. Once again, simply by the attendance today (the boycotting of the developed countries), we can see it's an extremely sensitive even to get in the same room to talk about this issue. I'm going to explain why that is and how we might come at that.

Finally, it's important to note at the outset how challenging this problem is and that past efforts to deal with this have failed. As you all probably know, in about 2003, the UN, and the IMF in particular came out with what was called a mechanism for sovereign debt restructuring SDRs. And that failed to gain support again because the developed countries did not get behind it. So we'll have to talk a little bit about why that is and what we can do differently this time in order to create a politically feasible response.

THE CATALYST:

So let's jump right into the first part of my presentation which is the catalyst. What I mean by catalyst is why are we talking about this now, what brings us all together at this stage to talk about it.

There are three catalysts that seem to me to be the predominant points to cover. One is the long history of sovereigns borrowing and not repaying. Let's go to the next slide.

This is a chart prepared by, actually since we're talking about chess a few moments ago, one of the great chess players in US history Ken Rogoff, and his colleagues at Harvard. They trot it out in a book that many of you I'm sure have read, which was entitled, *This Time is Different*. It's a book about sovereign defaults. Historically what they showed us is that although countries do not like to publicize this, sovereign debt defaults to external holders of debts, meaning people who are outside the country that borrowed money is an extremely common thing, far more common than most laypeople would ever imagine.

Now all of you here are probably well aware of this but it gives a little bit of a flavor to why it's extremely important that we put together some sort of system to deal with this because it comes up all the time.

I should also add that the frequency of this and the common aspect of it creates on

on many occasions, what I will refer to in my discussion as systemic risk, meaning problems that affect not just the countries and individuals involved in the specific contracts that I've described, but others in the world as well.

The second catalyst that I want to focus upon will be near and dear to the nice folks from Argentina, that I just said hello to. And that is the recent development of case law in the area of sovereign debt that pertained to bonds that were issued by Argentina several years ago, which were the subjects of massive lawsuits. And I'm going to spend a few minutes on this because it's important to understand what happened there for us all to understand the dimensions of the problem we're facing now, as well as to understand some of the solutions that I'm going to suggest at the end.

So, I don't know how many of you are lawyers here. You look like really nice folks. I assume most of you are not lawyers. You're a lawyer okay. I am too so that's ok! How many of you of you are lawyers, could you raise hands so I know whom I'm speaking with? Not that many, great so I'll take it easy here.

We're not going to go into detail about Argentina. But, in a nutshell, let's just imagine that all of you in this room had lent money to Argentina.

Right, and Argentina then came to you at a certain point in time "guys, I'm sorry I cannot pay you back right now. I can pay you back a little bit later, maybe a little bit less than I promised, but it's far better than having a mess by not paying you back at all. I would like you to agree to receive not \$100 on the amount you lent me, but rather I'd like to give you \$90. And I'd like a little extension of time."

Let's assume that all of you in this room, except for the nice person that I see sitting here from Guatemala, who does not know me, (hi, how are you?) everybody here says yes except for her. So you have all now received what are called exchange bonds. These are new bonds issued by Argentina, that contained the new terms of payment. And there's no problem from your perspective because you've all said fine to that. But, Guatemala, says, "I'm sorry. I'm not going to agree to it. And the reason I'm not going to agree to it is because my contract says you owe me \$100, and you have to pay me today. And I don't have any contractual obligation to alter that agreement. And I don't care that the rest of you want to do a deal. I'm not going to do it."

What Guatemala is called in that situation is a holdout. A holdout means someone or a group of bondholders who are not willing to enter into a new deal. They want their original deal honored.

But it can get worse for this lovely person from Guatemala.

What if I told you that she had bought these bonds not for \$100 as all the rest of us had but instead for 10 cents on the dollar. In this case, we'd call it \$10 out of the hundred. So she bought all the bonds for \$10. And she has the temerity to look you in the eye and say "fine you all want to take \$90, I still want my hundred dollars because I bought my bonds on the open market. Someone sold them to me because they were worried about repayment. And I'm going to stick with that deal, I have all the rights that that originally were in place there."

So that person is called a vulture. That's the terminology used in the world for people who do that. But as you can see that's just a contractual deal that's taken place and one can characterize it as good or bad and make moral judgments, but it's simply a contractual deal that's taken place.

So what happened in the case of Argentina, and how does it affect us? Why does this lawsuit matter? Well, in the Argentine case, what the courts did and it wasn't just one judge, went all the way up to the Supreme Court of the United States, what the court said was, "as to all of you in this room who accepted a deal that got you less money over a longer period of time. You're bound by that deal."

Congratulations. "And Guatemala gets to be paid everything that she's entitled to, including interest, including penalties, everything." So, what took place there is, it created a situation where in the future, it has become even more difficult for the rest of you to reach an agreement with a country like Argentina to restructure to get new bonds, because you're always going to be looking over your shoulder and wondering if there's Guatemala, sitting in the background ready to say no and ending up in a better position.

So, in that respect. I don't know how many of you have ever studied the prisoner's dilemma concept, but it does apply here. You actually have a situation where if you behave well, given the court decisions you could get burned and there may be incentive for someone to be a holdout because the court cases say "great you're going to get paid in full."

So, this is the problem that was created by the Argentine cases, these contracts were interpreted in a very strict way so that those who reached an agreement were essentially penalized for being reasonable. And those in the most extreme position from a perspective of equity, the vultures, made out extremely well.

Now, there's something that was not in the Argentine bonds that's extremely important to talk about today. These bonds are contracts, as I mentioned, simple contracts. There was no provision in these contracts that was called a collective action clause.

A collective action clause is something you're going to learn a lot about if you really focus on sovereign debt. It's a fancy way of saying that you can put in your document a provision that allows all the rest of you to bind Guatemala.

Typically, it would be provide for 75%. All it means is if 75% percent of the people holding these bonds want to do a new deal, then there must be something reasonable about that and it's not unfair to bind the other 25%. That takes care to some degree of this problem of the holdouts because you then have a situation where the vast majority can control the fate of the restructuring and you do not end up with a with a broken system.

Now, it does get a little bit more complicated than that. Because just as in this room, we have a lot of people voting on the bonds, I want you for a moment to imagine that, while we're having this meeting, there's a meeting in five other rooms taking place here in the UN, of people who are also holding bonds, but they're a different class of bonds. So they each have the ability

to block a restructuring, unless they also have collective action clauses in them. If they have a clause called aggregation, that allows there to be majority rule as among all of the classes of bonds. So that essentially let's assume that you had five rooms like this conference rooms filled with delegates voting on their bonds, if three out of the five voted to restructure and take x and exchange bonds, at that point, you would have a restructuring successfully accomplished.

So the takeaway from this that I'd like you to have in mind are really two key points. One is that as we look forward in time, and this is a theme I'm going to get to at the end, having collective action clauses **or** aggregation clauses in contracts, is a really good thing if you want to have orderly restructurings because it solves to a large degree, the holdout vulture type of problem.

And two, and this is extremely vital to understand, as of today, the world is faced with lots of bonds that do not have collective action clauses in them or aggregation clauses in them. So think about that, we have out there now and will for a dozen years at least, bonds that allow for this really difficult situation to arise, where individuals, and individual holders of bonds or groups of bond holders can get together and essentially block the restructuring process.

Sounds pretty gloomy but it gets better.

Now, the third catalyst that I had up on the screen here is the reason why we're talking today, namely the UN vote in September of last year. You voted overwhelmingly to put on your agenda the creation of a framework for restructuring. As I mentioned, this is not the first time it's happened. And it is not a popular subject among the developed countries, for reasons that will become quite clear.

KEY QUESTIONS

So, let's talk now about a few of the key issues that I'd like you to be at least familiar with before I talk through the framework that I'm going to propose. And I want to highlight these key questions, because it's important for you, I believe, to understand why my proposals are fairly modest. I want you to see the complexity that we have to deal with.

The first concept is whether we're going to have a private or a statutory framework as shown on the screen or whether there will be some sort of hybrid. A private framework or private approach just means let the marketplace deal with this. Let the high paid and experienced lawyers representing sovereigns and representing bondholders adjust their agreements to solve the problems. That's of course an important dimension to this. That's already happening and will continue to happen.

The second choice is to have a statutory framework. That is what you're all considering having, something that the UN adopts or that the IMF adopts, something that's along the lines of a convention, or a set of rules.

A third choice, the hybrid approach, which I'll be advocating is essentially a combination of the two.

Most would instantly agree that the private market is going to continue to function and try to deal with issues to make the market more efficient. But I think the statutory side is important because the private market as you'll see does not deal with some critical issues that have to be addressed.

19:39

Another key question is how does this relate to the IMF and politics? This, Of course could be the subject of an extremely long discussion. I'm not going to focus upon the IMF but I do want to simply make a note that the IMF is there to essentially serve as the fireman to deal with situations where restructurings are not successfully put together, or default is in the air, and where contagion, or even the more extreme systemic risk is an issue. So, any framework has to take into account the IMF role, and the role regional groups that play the same type of role that the IMF does throughout the world.

A similar issue is how would a framework affect sovereignty. Simply by virtue of your having voted to put this on the agenda, you're really saying that by putting a framework in place, sovereignty is going to be in play. We are going to be compromising to some degree national sovereignty. Anytime a convention is put in place, we have to be sensitive to where those lines are. And that touches of course on why some people are not attending today.

The next issue is even more directly on that point. Why would the US and the UK go along with the framework? Why did I pick out those specific countries when, as we can see now, we have a variety of countries that are not present here? I picked the UK and the US because those are the countries whose laws and jurisdictions are typically chosen in the bond documents to resolve disputes so they're the ones who are most directly affected by any sort of an effort by an international organization such as the UN to potentially limit or change contract rights. That's one of the many issues that they're concerned about. Please keep in mind that if you want your efforts to result in something feasible, something workable, we're going to have to deal with the issue of how the US, UK and other countries that are boycotting today look at this. We have to address it or we're not going to get anywhere.

PROPOSED FRAMEWORK

Finally, a framework. In order to be successful it has to be perceived as fair and legitimate. Nothing in my view is more important than that theme in dispute resolution. A little history here to underscore how this plays out. Several nations recently established competitors to major international financial institutions. As you may all know China, for example after long complaining that the IMF, World Bank and Asian Development Bank were dominated by the interests of the US, Europe, established, along with a few other nations, the Asian Infrastructure Investment Bank. The IMF, England, many others announced their desire to cooperate. But the US voiced very strong opposition.

The New Development Bank was very recently founded by the BRICS, which is of course Brazil, Russia, India, China and the S stands for South Africa. This was also expressly designed to counter the unfairness perceived by these nations in the governance of the IMF and the World Bank.

So, I bring this up to point out that as we consider a design for a framework for sovereign debt restructuring, we need to keep in mind these recent developments which underscore the distrust that many countries have of Western institutions.

So these are pretty complex issues, they are the intersection of international law and domestic politics with this all taking place in the context of the Cold War perhaps starting up again and a lot of international stress.

To make this politically feasible, from my perspective, we're going to have to focus on fairly modest steps, initially, and you'll hear soon that they're going to be largely procedural steps and conceptual steps. I'm going in that direction because the logical starting point is to skirt the tricky fairness issues and try as best we can to bring to the table the groups that are not with us now. Let me now begin to talk in the next screen, about the actual proposed framework.

First, I want to identify some of the problems that we can address through a sovereign debt restructuring framework, and also talk through those things that are weaknesses in the status quo. And finally, as I said I promised to let you have target practice and I'm going to do that by putting out the framework itself.

In terms of problems we can solve, there are several that I think are on the table that are there for the picking and these address: the slowness of restructuring; the lack of a forum where everybody can get together to discuss issues; and the effect of delays upon the debtor nations as well as upon the cost structures of the bondholders. The things that we can work on are: the coordination of restructurings; the speed of the restructurings; the efficiency, process and predictability of restructurings.

What are some of the things that at least in my view we cannot address right now? I'm putting these out there because I'm trying to get us thinking together about how to bridge the gaps between the developing and the developed nations. I don't think that SDR is going to be particularly effective in dealing with what I will call the moral hazard issues or the systemic risk issues or the political issues.

Moral hazard cuts in various directions, it's the likelihood that countries borrow more aggressively, because they know that they have the fireman of the IMF standing by to come into the picture to bail them out. Similarly, you've got bondholders who to some degree view the potential for IMF capital coming in as a means of giving them a backstop anytime a government comes into private markets to help, such as the IMF does. You're going to get distortions in that market and that can create moral hazard.

Likewise I don't think we're going to get to systemic risk, at least on the back end of restructuring, but I'll talk about that in a moment. A framework that in any way attempts to take what are essentially political decisions and put them in the hands of an international tribunal (that might be the structure some would advocate for) is just not going to fly from the perspective of developed nations. I think that's just a reality we have to deal with.

So let me talk a little bit about the political side because I think it's really important for this to be driven home. And I don't want to beat up on Greece here (I'm not taking a side on Greece), but it's a good example to talk through for a moment. A report came out noting that Greece borrows too much, that it spends too much on social services and does a poor job collecting taxes. These are all familiar themes to you. But this report came out in the mid to late 1800s. And in the early part of the 1800s, there was a similar situation that had developed, where Greece was fighting for its independence from the Ottoman Empire. Loans were extended in that context with the help of Europeans including the British. The French and Russia were involved too, all supporting Greece. Debt repayment problems started to arise back then along with very complex political issues illustrated by the identity of the first king of Greece-- Otto, the 17 year old son of the Bavarian Ludwig, who was brought over on a British ship to Madagascar, and protected by soldiers of the three countries.

Eventually as trouble with collection issues increased, they put three British warships in the port of Piraeus to see if that would help!

They were talking back then about the difference between the core and the periphery, some rather similar themes as we have today. Moreover Greece back in those days was being courted by the European powers. After they had finished the battles I just described with the Ottoman Empire. There was a battle taking place against Russia. The teams had changed, and everybody was trying to keep Greece from siding with Russia. Again, a rather familiar theme for those of you who may have noted that one of the first phone calls made by the new Greek Prime Minister Tsipras was to Russia. The politics continue.

So, my only point is that the political issues that we're facing today in the context of sovereign debt restructuring are absolutely nothing new. They've always been there and, at least from my perspective when you have major restructurings in geographically or politically important countries, you're always going to have politics involved.

Today, the resolution of the Greek issue is going to affect the viability of the eurozone, the prospects for success of the EU itself and Europe's ability to remain united in responding to pressures on the Ukraine.

So for all of these reasons, any sort of a framework that impinges upon the ability of powerful developed nations to use the political levers they wish to resolve what are far more complex problems than just sovereign debt, are going to be non-starters. That is why back in 2003, the sovereign debt restructuring mechanism that the IMF proposed was rejected by the developed countries. And that is why, if we go down that same road today, of trying to have substantive provisions in a sovereign debt restructuring mechanism, we're going to hit the same roadblocks. Politicians are not going to let judges make any decisions or apply pressures that would impair their ability to deal with what they view as fundamental political issues in the world.

Let's talk now about the deficiencies of the status quo. And this gets to the point-how do we make the argument to the developed countries that the current status quo is not satisfactory, and that they have an interest in changing it. First of all, we talked about the holdout problem. That problem exists and is going to exist for years to come due. It cannot be addressed solely by the bilateral negotiations of

parties, the current system also does not allow for new funding to come in. We do not have a forum that allows people to get together and agree. To use the example I gave you before-- If you have an exchange offer and you've accepted \$90 on \$100 debt, we don't have a mechanism in place that allows a new lender to come say, "I'm going to help this debtor by putting in fresh capital. I'm going to put in another hundred dollars but I want my hundred dollars to be repaid ahead of all the existing creditors."

That is a typical mechanism that one would have in any bankruptcy regime. It's a mechanism that would be necessary in a sovereign debt restructuring regime. We do not yet have a forum that allows for that discussion to take place.

There's a final and in my view critical reason why the developed countries should want to participate in this process if we do it the right way. And that is because the status quo provides no systemic defense. We have the IMF out there as a fireman, coming in at the last minute to douse the flames. But there is no system in place that allows for systemic defense to be incorporated into contracts. There's no way for people to get together today to talk about the issues. And indeed, as you can see, it's volatile, even to have a conversation about setting up a forum to do that. The developed countries have a huge interest in avoiding systemic failures and in avoiding having to fund the IMF constantly to go in and maintain this role, not just of a fireman, but over time, as an entrenched participant in the markets.

Let's turn to the next slide.

Now that I've identified some of what we went through the areas we cannot resolve initially, here are the suggestions I would have for you to keep in mind over the next several days. I've undersold a framework by describing it as modest.

The majority of the provisions in the bankruptcy laws of most countries are procedural. So, it is a big deal to put in place procedures that bring people together. But the main theme of any framework in order for it to succeed, and to be able to be built upon is that it must be consensual. You're very familiar with that here in the UN. We have the good example of the International Court of Justice, which functions quite well. It's consensual. There's just no way you're going to have anything other than a consensual structure. You're not going to get the powerful countries to agree absent that. It has to be open to all relevant parties, including the IMF. It must be focused on rules and procedures.

It cannot be focused on substantive law unless it's applied with the consent of those who wish to use it. Let me explain what I mean by that. There is nothing unusual about having a consensual forum where people utilize the opportunity to have their disputes resolved. They can either apply the law that's already in their contract and have the forum resolve it for them, or they can decide together at that time that they want to have it resolved by another substantive law, but it has to be consensual for it to be functional and for people to sign up.

Who would make decisions? It must be impartial, independent facilitators. I'm not envisioning decision makers, unless the parties want a decision. They have to consent. But it can be extremely useful to get everybody in the same room to talk about the contagion risk to talk about sustainability and debt

service, key issues at the IMF in particular focuses on. We also can take major steps, such as formulating creditor's committees. For those of you not familiar with that concept it's very simple. Let's say you have 100,000 bondholders, and you may not want to have a meeting with 100,000 people you form committees that represent those people. This is very commonly done in the insolvency context.

We should not focus, in my view, in any sort of a debt restructuring mechanism framework upon enforcement. If you go towards enforcement, you're going to hit the roadblock of countries saying they're simply not willing to give up their sovereignty in that regard. The enforcement is going to have to be the way it is done with the world court and other jurisdictions that are consensual. It's got to be market driven and based on the pressures that come from having consent in the marketplace.

Finally, an important goal of the framework is to focus upon the private market participants. Once we pull something together, sell it. Get the private market participants behind it, get their input and make sure it works for them because we need to have an active debt market. We need to have the capability for the secondary market of debt to function, meaning to have contracts sold afterward.

All of these things are big steps, even though they do not go as far as some may advocate in terms of actually creating an international tribunal that would decide issues.

CONCLUDING COMMENTS

So let's now go to the next slide, which is simply my concluding comments, which is a bit of a misnomer because I still have a few things to say. Many advocate the creation of essentially an international bankruptcy court and a good deal has been written on that. That to me, would be a far later stage of development if we were successful first and putting together some sort of a procedural framework to help create some consensus.

I want to first say I would encourage you to have teams working on the creation of a tribunal and starting to hash through the many issues that come up in that context but I'll give you a few examples of the issues that you'll face, and I think you'll understand why I'm encouraging us to go in a more modest direction first. The moment you have a tribunal, you'll have to figure out where it's located, and who the judges are on the tribunal. Good luck. That's going to be really interesting to figure out who's going to make decisions. You have to decide what their jurisdiction is, what the judge may decide, and what kind of issues may be addressed.

Let's take the simple situation of the US bankruptcy laws-- it's no different in many countries throughout the world. Bankruptcy judges know what their marching orders are, they are assigned the task under Chapter 11 in the US to try to restructure the companies to try to keep them alive because companies that are alive create jobs, and that's a good thing for economies. So, that is one of the target goals of judges and if a judge doesn't have that in mind, the judge doesn't know what to do when people come before him. You need to know what your goals are in the context of sovereign debt restructuring. You're going to have to figure out whether the judge's job is to enhance the liquidity of the bonds, so that the market functions well, or instead to protect an issuing country's interests over the bond holders to protect their economies. Is it a combination of those factors, or any number of other complex factors?

Are we trying to put forward an agenda through the tribunal that supports the IMF? I think you're going to find that giving marching orders to a court would be an extremely difficult thing to do. And it would get back to this fairness issue that I talked about at the beginning.

This is a situation where, in my view, less is more. Because the more substance you put into a framework, the more difficult is it is going to be to agree that it is fair. When you bring all these countries together, the less substance you have in there, the more likely it's going to be viewed as fair because you're going to leave it to the participants to do consensually what they wish. And that is going to take away one of the primary objections of members of the private market currently, which is they do not want to have in place a system that impairs their ability to contract freely.

Finally, under this tribunal system you would have what I call "rubber meets the road" issues. You're going to have to think through what law is going to apply to resolve disputes and put yourself in the position of lawyers that are representing countries or representing bondholders. How do you advise your clients to put in a choice of law provision and choice of forum provision that's brand new? says, un You must have precedent that you can point to, so that you can advise your clients on how their rights are going to be adjudicated and how the process will work. Lawyers simply are not going to jump into this without some sort of testing. Maybe the way to do the testing would be a pilot program perhaps in the EU where they've already given up some sovereignty so the issues may not be quite so sensitive.

So there is no reason not to start down this path, but I would do it only as a behind the scenes effort to see if you can make progress on those thorny issues. I think if you put that out publicly, you're just not going to find a way of gaining consensus.

Now I would like to talk about the final subject today in my closing remarks. And that is really what I think is a subject that has not been addressed in the literature on sovereign debt restructuring. Because, in a way, it doesn't fit with the terminology "sovereign debt restructuring" which by its very nature is a back-end concept. What I mean by that is you've already had the contracts entered into, you've already borrowed your money from the bank to buy the car. You can't pay it back. And now you're sitting in a room with the bank talking about your problems. That's a restructuring.

I would like you to think about including in your deliberations the front end. What do I mean by the front end? I'm referring to regulations. Let me give you an example to make this clearer. Let's say that you've hired an electrician electrical contractor to put in wiring in your home.

(Just, just a second. Sorry to interrupt you, but I have the honor to announce the presence of the Minister of Foreign Affairs of all salvadore Excellency, please. excelencia Praveen bonito would like to welcome.)

So I was beginning to provide yet another colorful analogy for you. Let's assume for the moment that you're living in the middle of a major city like Manhattan or Chicago, and you're doing electrical work in your home. You hired a contractor to come in and do that work. And he's basically said "you know I can do this a little bit more cheaply by using these used wires that I got from an old home." And you say fine. That's a matter of contract between two people. You are perfectly free to make that deal and save

some money. The contractor puts in the used wires and, as you might guess, a few days later, a fire breaks out. And at that point, it's a problem for your neighbors, right next door. That's called contagion because it's an effect of your bilateral contract upon others. In the context of sovereign debt restructuring, if there's a problem with Greece, then the spread of the problem to Portugal, Italy, Spain is contagion.

What is systemic risk? Well that's if this fire spreads beyond your neighbors putting the entire city at risk. So, my point is that there are situations where the private dealings between people, as in the case of sovereign debt deals, have effects that that are significant beyond that private contractual arrangement. To protect against systemic risk, we bring in the firemen which is the IMF to try to douse the flames.

But wouldn't it be more logical to do something creative such as what we do in the situation of the electrician. We have laws in place. We say that if you're going to put in wiring in a house, you have to use wiring that's approved, that's safe. And maybe we take the additional step and say that you also have to put in the new homes a fire alarm. The reason we put in those regulations is not because we want to interfere with the contractual rights (we still want everybody to contract freely), but because we recognize the systemic threat. Therefore, it's appropriate for us to step in and have some limited regulations.

To broaden the analogy. That's what we were supposed to do in the United States after we had the meltdown in 2008, the "too big to fail problem". If you have a "too big to fail problem" that's the same type of thing. You have private parties taking actions together that can affect the entire system. The proper response once you put out the flames is to pass some type of regulatory scheme so that you do not find yourself in the same position again.

So, what am I suggesting to you is not to think of sovereign debt in your work over the next several months as only a back-end issue. If you want to get to systemic risk, which to me is really the heart of it, and the part where the Western countries and the developed nations have a significant interest, then focus on narrow consensual regulations that you can come up with to help reduce the risk of a fire down the road.

What are some examples of regulations? Well this harkens back to the beginning of my speech when I explained collective action clauses. If for example you reach the conclusion that collective action clauses and the related aggregation clauses that I described are really good clauses to have in sovereign debt instruments, you could say as part of your convention these types of terms will be mandatory in all sovereign debt instruments. You would in essence be telling people "you're free to contract as you wish but you're not free to exclude provisions the absence of which create risk for all the rest of us."

Another provision you might consider would be one that provides for a standstill. When there is a sovereign debt restructuring crisis contracts would contain a provision that precludes litigation for a three-month or a six-month period. During that time the parties would get together in a forum to negotiate.

So your challenge would be to come up with a small number of regulatory items that deal with the front end of the problem and that are agreed upon by the developed countries and the undeveloped countries together as reasonable—to avoid a race to the bottom. And what I mean by that is, you do not want a situation where you have electricians marketing their skills on the basis that they can use cheaper and cheaper products which cause the potential for fire hazard. You want to set a floor below which people cannot go.

Why is this fair to all parties? It's fair because if it's in the contracts due to your efforts at establishing a front-end regulatory scheme for future contracts, those terms will actually be in the contracts. There's nothing unfair about that. That's completely different than what the US and other developed nations are fearful of, which is having some tribunal altering the contracts after they've been executed. Our job then is one of consensus building. This process has already begun --you're doing it.

We recently had a retreat to work on a plan. To make it more fun it was a nature retreat we all piled into boats and canoes and we had a really nice time talking about this. We had Joe Stiglitz there. He was on the shore yelling instructions to us. I think we have a picture of it that was taken by the Economist. And as you can see, it's a thematic picture.

This illustrates my point today. It's really great for us to paddle faster on the back end with the restructuring. But paddling sooner, is the key thing. And as I hope I have demonstrated to you today, that can make all the difference. Thank you.

Richard. Thank you very much, Richard. Very enlightening explanations. (Questions posed by UN delegates not transcribed.)

For that statement and for your contributions.

And I would call first on Mr. Conn to offer comments in response to the questions.

Thank you both very much, Mr. Chairman.

First, I would like to thank all of those who posed questions for their excellent insights and really strong questions.

I'm going to try to cover them in order and I hope I'll be comprehensive and brief.

First let me thank the representative from Guatemala for her good humor in allowing me to kid Guatemala as the example of vultures. That was the most far-fetched I could come up with.

Thank you for being kind to me. When you began to ask a question, I was a little bit worried that you would get some payback. Since I did use you as the example, you're very, you're very gracious.

So you'd asked a question about whether there were previous SDR efforts. The effort in 2002-2003 was led by the IMF. That is the only formal effort that I'm aware of that has taken place. Much has been written about this subject for years but that was a coordinated effort. As one of the gentlemen, just mentioned in his preface to questions it was not successful for a variety of reasons.

I think foremost among those was that the IMF effort tried to be too substantive-- it tried to do too much, and that ties into the points I made in my presentation. I think if we go too far, we're simply not going to bring aboard countries that are concerned with too much power, too much sovereignty being taken away.

Who's in charge of the balancing of goals? You asked how that would take place if we had a tribunal. So let's let me just categorize this in terms of how I present it. As I said, it's just my opinion. Many may differ. I don't think that a first logical step is to try to set up an international tribunal. Simply because I think that walks right into the minefield of loss of national sovereignty, who decision makers are, how things are enforced etc. I would love to see the day come where we can do that but I think this has to be a gradual progression. And I think it's going to be probably another century before we're at a point where we have full enforcement of rights among different countries, it's hard to do. We need a lot of trust and to get that trust, we have to start by having procedures that work and people working consensually.

But to answer your question, I do think eventually one could come up with a series of instructions for the tribunal to follow that would give the tribunal factors it would need to consider in evaluating how to resolve a sovereign debt issues. Those could include the ones that I mentioned: the well-being of the country itself; the efficacy of the country in implementing the IMF steps that the IMF has asked for to help stabilize it and create sustainability. In addition, the court could take into account, and should of course take into account, the rights of the bondholders. But these are really tricky areas and I just want to make sure I say one thing very clearly in response to your question. Let's not forget that we do not want to kill the golden goose. The entire concept of sovereign debt restructuring rests on the willingness of individuals, of decision makers who have capital, to provide that in the form of a loan to nations that wish to borrow. These are not loans between countries, these are loans between people with money, and those that want the money to be used. The people who are lending the money while they may be good natured folks, want to make money. That's why they're doing this. If we set up a system here in the UN that creates any uncertainty about the ability of someone who's lending money to get repaid in accordance with their contract, that would be counterproductive.

And that can include provisions that allow for modification of the contract. Again, people would have to agree to that up front. If you knocked that out, and you instead put in place laws that they do not understand or that are new and would apply after the fact, you're just not going to get people lending money in the future. We always have to keep in mind this is a market-based concept. When we're coming up with a framework, it needs to be something that all the market participants would understand, feel is consensual and feel is fair, rather than putting them into a quandary about what their rights will be.

So that ties to your point about how a tribunal would work. People are not going to lend money if there is a judge they do not know, a tribunal without precedence. If they do not understand what the judge is going to rule based on and if ultimately those provisions are not incorporated in their bond documents, it won't work. The bond market has to function in order for sovereign debt restructuring problems to exist. In this sense we're lucky to have the sovereign debt restructuring problems because we have sovereign debt. So we don't want to knock that out.

Let me turn now to a couple of other questions, the delegate from China, thank you for your clarification of my comments. I took my comments from literature that described why the Asian Infrastructure Investment Bank was created. I certainly defer to you regarding what the intentions were. But what I did find useful about the commentary I had read about the reasoning is it helped to illustrate my point today, which is that there is, and I believe most of you in this room would agree, some level of distrust and dissatisfaction from a fairness perspective with some Western institutions, and I'm simply saying that I think if we're going to have a framework for restructuring, that is accepted worldwide, western countries, the developed countries in particular, have to take this sentiment into account. That's the point I was trying to make with it.

Let me turn now to the comments of the gentleman, the representative from Sudan.

I think that if the representative asked the question what would be the impact of this new bank? First, I'm a big fan of competition. I think it's a wonderful thing to see new alternatives created that could be viewed as competitive to the World Bank, IMF, or any other organization. That should result over time in better functioning in that market. I think that's a positive. The effect will be that we probably will see changes in the organizations that have historically been servicing Asia, simply because of those competitive elements. In addition, I think it's a nice shot across the bow, as I've mentioned to the Western and developed countries that there is some level of concern in terms of how these institutions are being operated. Ultimately, from my perspective everybody in the world wants to feel that they're treated fairly, everybody wants to feel there's a fair process. It is a signal that that is not taking place when new institutions are developed that provide overlapping services. But at the end of the day I don't think that's a bad thing. I think the markets will be better served.

There also was the first of several different comments made about vulture funds. And let me start off by saying, I have no relationship with any particular vulture fund.

It's not my nature to pick up and defend them but I am a believer in freedom of contract. And I think for the reasons I just stated, we want to be very careful about creating bad law based on bad facts, meaning just because we have vultures out there in the market that are buying up debt at discounted prices. We want to be very careful not to interfere with the functioning of marketplaces because that can affect the ability of people who want to provide capital to countries to do that.

What I would encourage us to do is what I said. Think about it from a regulatory perspective, I would certainly not see a problem if we could come up with some sort of regulatory aspects that might protect the market in terms of the role of vulture funds, but I don't think it's a healthy thing to think of it as a back end resolution.

It would be in my view, a really dangerous concept to be saying to the market “if you're a smart buyer, and you buy up distressed bonds at a low price, you're going to find that your contract rights are not respected.” The moment we start attacking contract rights, I think we're harming the goose that lays the golden egg so we have to be very thoughtful. Regulation is different. Regulation is front end and the market and contracting parties know that those are going to be the terms in their agreements. That you can do, but you can't change the deal afterward without a reverberation.

Not sure there were a lot of other comments. I think I covered the comment as well as the delegate from Egypt, which had many, many good suggestions for the way forward. I would only say that while I share your sentiment of the desirability of a bankruptcy court concept, for the reasons I presented today I just think that has to be an iterative long-term goal. I think if we can start by getting everybody in a room talking discussing threats to the system and about what we want to do together, that's a very different element than having powerful developed nations feel that the conversations will be about setting up a tribunal which will take decision making from them. It's for that reason that I think it has to be over time.

I hope that's responsive to all the questions. Thank you once again for being so attentive today.

Thank you very much, Mr. Richard for those responses. I call on Mr. Richard Wright from UNGA who as you all know, is working very hard in support of the work of this committee. So I'd like to take this opportunity to pay tribute to the work that he is doing. Just a real just a point of historical verification on the Guatemala problem. The question from the honorable representative of Guatemala UNCTAD back in the 1980s in response to the Latin American debt crisis was the first international institution to talk about the need for international bankruptcy regulation drawing precisely on chapters nine and 11 of the US Bankruptcy Code. I think it was very much in the spirit of what Richard talked about. It was trying to tease out possible front loaded regulations that would make, I mean those were the many of the ones who talked about standstill, the need for standstills to be in place at the beginning of a contractual process, the need for lending into arrears being recognized, etc and it's in a point that Stiglitz himself has always made that in a world of increasingly internationalized markets. It's very funny that a number of countries, resist the internationalization of their market rules that have made their own markets domestically work. So, effectively, and it's that contradiction that we've always struggled with a little bit in UNCTAD, and I guess related to that and maybe Richard can respond to that. I mean there is a sovereignty issue but we have seen in international transactions over the last 20 years the ceding of legal authority in the area of trade and investment deals to international courts of arbitration courts that are increasingly contentious. In, for example, ongoing discussions at the moment on, on trade deals. Some countries, including some prominent advanced countries don't seem to be willing to cede authority as a general principle. It seems that whilst they are willing to cede that authority in some areas, they are resisting it in others. I'd just like his response to what seems to be an ambiguity in international legal processes in that respect. Thank you, Richard. Thank you very much, Richard.

Thank you. It's an excellent question.

First, I do think that there is some level of inconsistency if you want to think of it that way in terms of how some Western countries use the US as the example on issues of fairness and due process. We in the US, from a legal perspective, take the view that US citizens are entitled to the fairness and due process but our constitution limits this to the US territory.

I think that over the course of the last century and in this new century, I think there's more of a flavor creeping into the US and other Western nations for the idea that while that territorial limitation may be right in terms of the development of nation state and constitutions, the idea that others should also be treated fairly seems to be more and more pervasive. That to me is what I would refer to as the spread of civilization.

But I think technically we reached some complicated issues because from a technical perspective, we do have these constitutional issues that come up as to the ceding of authority.

I think the reason why there is particular resistance in the area of ceding authority for sovereign debt restructuring, is because as I was trying to illustrate in my talk, these issues can be incredibly political and can be tied in with so many different major issues throughout the world.

Policymakers may speak for themselves in this but I can well understand that if I were in the position to make determinations about how the US wants to deal now with Russia, for example, I would not want to be worried that there is a tribunal that's going to in some way affect my ability to do some sort of a deal with Greece, that may have an impact on that. Simply because the issues go far beyond the relatively narrow questions of sovereign debt restructuring. I think it's for that reason that there is a high level of concern that walking down the path of creating tribunals in this area ultimately will result in more authority being ceded to other nations than the powerful nations that call the tune on these on these political issues wish cede at this stage. So that would be my candid answer to it. I just think it's different in kind, it's broader than some very narrow trade issues.

And then these potentially affect, four or five of the biggest issues facing Europe and Western nations today. I just don't think that politicians want to worry about the leverage that can be created in what are already very complicated matters

Thank you very much, Richard.

Thank you for being here, really honored to have you here but also to have sharp focus on these important issues. I also wanted to extend my appreciation to Mr. Conn for that very instructive and very interesting presentation and also thank you for presenting his points of view on the issues for the consideration of member states.