



Financial Markets Law Committee (“FMLC”)

Sovereign Debt Scoping Forum

Date: Friday 2 June 2017

Time: 8.30am to 10.00am

Location: Bank of England, Threadneedle Street, London EC2R 8AH

In Attendance:

Deborah Zandstra (Chair)	Clifford Chance LLP
Nikita Aggarwal	Queen Mary University of London
Antony Beaves	Bank of England
Carter Brod	Morgan Lewis & Bockius LLP
Karl Clowry	Paul Hastings LLP
Francis Fitzherbert-Brockholes	White & Case LLP
Jim Ho	Cleary Gottlieb Steen & Hamilton LLP
Yannis Manuelides	Allen & Overy LPP
Habib Motani	Clifford Chance LLP
Professor Rodrigo Olivares-Caminal	Queen Mary University of London
Tolek Petch	Slaughter and May
Cecil Quillen	Linklaters LLP
Venessa Parekh	FMLC
Thomas Willett	FMLC

Regrets:

Lachlan Burn	Linklaters LLP
Emma Dickinson	Deutsche Bank AG
Michael Godden	Norton Rose Fulbright LLP
Leland Goss	International Capital Market Association
Robert Gray	
Mark Joy	Bank of England
Duncan Kellaway	Freshfields Bruckhaus Deringer LLP
Professor Rosa Lastra	Centre for Commercial Law Studies
Harry Lee	HM Treasury
Yanying Li	Asian Development Bank
John McGrath	Sidley Austin LLP

Registered Charity Number: 1164902.

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Reena Parmar
David Sabel
Harriet Territt
Philip Wood QC

Freshfields Bruckhaus Deringer LLP
Cleary Gottlieb Steen & Hamilton LLP
Jones Day
Allen & Overy LLP

Minutes:

1. Introduction

1.1. Deborah Zandstra opened the meeting and gave a brief introduction.

2. Recent Islamic issuances, including the Saudi Arabian sukuk (Habib Motani)

2.1. Habib Motani began his talk on Islamic issuances by identifying the countries which regularly issue sukuku: Saudi Arabia, Oman and Turkey.

2.2. Mr Motani highlighted two key concerns surrounding the sukuk issuances. First, most sukuk issuing sovereigns, including those mentioned above, had incorporated collective action clauses (“CACs”) along the International Capital Market Association (“ICMA”) terms in their terms and conditions.¹ Malaysia, which has not opted for CACs, represents a debate between sukuk issuances and conventional issuances. Saudi Arabia, Oman, Egypt and Turkey tend to use both sukuku and conventional bonds, since the sukuk market is not deep enough. Second, Mr Motani touched on the relationship between sukuku and assets. If a sukuk is asset-based, securitisation retention requirements may be activated; in contrast, if the sukuku are considered collective trusts, this raises questions about how they may be dealt with under traditional (tax, etc.) legislation.

2.3. Focusing on Saudi Arabian sukuku, Mr Motani pointed out that these sukuku incorporate a historical payment mechanism by preference of their scholars; i.e., about half the money raised is put towards paying subscribers and the rest is assigned to infrastructure undertakings. This model has been discarded by other sukuk issuers.

2.4. One Forum member asked if the sukuk would be undermined if, due to single limb aggregation, conventional and Sharia’-compliant bonds were pooled during any restructuring. Mr Motani agreed that this is a genuine concern for Islamic scholars as conventional bond-holders could, in the event of pooling, impose terms which are not sharia’-compliant. Another participant emphasised that the problem lies in the diverse

¹ The International Capital Market Association, *Standard collective Action and Pari Passu Clauses for the Terms and Conditions of Sovereign Notes* (August 2014), available at: <https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Primary-Markets/primary-market-topics/collective-action-clauses/>

structures of sukuk and conventional offerings. Any determination of compliance with the two types of bonds would depend on the importance given to the sukuk's structural aspects.

2.5. Mr Motani concluded his talk by expressing that sukuku were popular enough to impact International Monetary Fund (“IMF”) statistics and any reform of English law.

3. A short summary on the case study of Puerto Rico's debt restructuring (Jim Ho)

3.1. Jim Ho articulated the statistics surrounding, and the events leading up to, Puerto Rico's sovereign debt crisis. Since 2006, Puerto Rico has been in recession and currently faces approximately \$70 billion of bond debt and \$50 billion in pension deficit.

3.2. Two key issues in Puerto Rico's debt restructuring were highlighted by Mr Ho. First, Puerto Rico's debt was issued by at least 18 different issuers, and its debts are held by a myriad of different creditors ranging from retail holders to hedge funds which makes balancing their demands and negotiations complicated. A second problem arises from Puerto Rico's unusual legal status as an unincorporated territory of the U.S. As it is not a municipality, it could not avail itself of the protection under Chapter 9 of the U.S. Bankruptcy Code.

3.3. Mr Ho outlined the Puerto Rico Oversight, Management, and Economic Stability Act (H.R. 5278, June 13 2016) (the “**PROMESA**”), which was introduced by the United States Congress as a process for restructuring the territory's debt. Two tools were described by Mr Ho as avenues for debt settlement:

- i. Title VI: which provides a largely out-of-court procedure ; and
- ii. Title III: which provides in-court procedures.

3.4. While the administration had a preference for Title VI initially, the tool comes with three key disadvantages:

- i. it does not provide for a moratorium unlike Title III;
- ii. it only applies to financial debt (such as bonds but not pension deficits); and
- iii. there is no cram-down procedure in contrast to Title III.

3.5. Title III borrows heavily from the Chapter 9 bankruptcy code. It is more time consuming as it involves a court process. Title III's key advantage is that it includes cramdown provisions, which can bind dissenting creditors to a plan that is signed off by

the oversight board and the courts. Title III is relatively untested, aggrieved creditors will certainly find novel issues to litigate.

- 3.6. Mr Ho mentioned that in the last month, four Puerto Rico debtors including the commonwealth have filed for Title III bankruptcies. More issues are likely to file in the coming weeks. The Forum members noted that Puerto Rico's situation will provide a blueprint for similar U.S. territories experiencing bankruptcy and raises the issue of whether processes like this should be court- or market-led.
- 3.7. The Forum members agreed to hold a follow up discussion on this topic at the next Forum meeting in September.

4. Update on the Russia/Ukraine eurobond litigation (Nikita Aggarwal)

- 4.1. After recapitulating the update delivered at the previous Forum meeting,² Nikita Aggarwal confirmed that the Trustee (Russia) had been granted summary judgment. On 26 May, Mr Justice Blair also granted Ukraine leave to appeal.
- 4.2. Ms Aggarwal outlined Ukraine's unsuccessful defences:
 - i. Ukraine's argument that it did not have the capacity to pay because of Russia's breaches of domestic laws was dismissed as the Court deemed that Ukraine continued to have the authority to borrow and fulfil its obligations;
 - ii. Ukraine's questions of duress and countermeasure were not judged not judiciable under English law; and
 - iii. Ukraine also argued that the counterparty (Russia) had prevented it from paying by crippling it economically. The Court ruled that Ukraine could have sought redress through the structure of the bond.
- 4.3. A discussion on authority was held by Forum members. One participant emphasised that authority is normally treated as a matter for domestic law. Ms Aggarwal clarified that the court treated "usual" and "ostensible" authority as interchangeable; noting that thirty-one previous bonds had been authorised.

5. Update on the regulation of GDP-linked bonds (Yannis Manuelides)

- 5.1. Yannis Manuelides reported to the Forum members that talks on GDP-linked bonds had failed to make headway at the recent G7 meeting. At private meetings on the subject, too, debt management agencies and big investors still conveyed reservations and the idea

² Minutes from the first quarter meeting can be found [here](#).

lacked momentum as investors and governments alike focused on the costs behind the bonds. Mr Manuelides drew upon a recent publication³ by the IMF on “State-Contingent Debt Instruments for Sovereigns”. In this paper, the directors saw developments in GDP-linked bonds as interesting, but ultimately expressed the opinion that the IMF should not prioritise this. The paper also covered linkers, floaters and extendibles while focusing on analysis of GDP. The paper also noted that the greatest benefit of GDP-linked standards is that it would create a model for other countries, for example, with respect to more conventional bonds.

5.2. Mr Manuelides summarised proceedings at a recent meeting hosted by the Bank of France, in which there was general support for GDP-linked bonds from the central banks.

5.3. The participants agreed that GDP-linked bonds are a great product for middle and low income countries but a precedent needs to be set by a high income country, such as Germany or Canada.

6. Administration:

a. a short presentation by Venessa Parekh on the operation of FMLC Working Groups;⁴

b. discussion on timings for the Forum meeting on Friday 8 September

6.1. Venessa Parekh described the different characteristics of scoping fora and working groups: how working groups can be initiated and established; the objectives of working groups; the conduct of business of working groups; and how the Secretariat supports working groups.

6.2. The Forum members resolved to move the third quarter meeting of the Sovereign Debt Scoping Forum, taking place on Friday 8 September, to the afternoon, in order to accommodate the participation of guest speakers from New York. Subsequent meetings, however, will remain in the morning, unless other key agenda items require speakers from the U.S.

7. Forum questions:⁵

³ The International Monetary Fund, *State-Contingent Debt Instruments for Sovereigns* (22 May 2017), available at: <http://www.imf.org/en/Publications/Policy-Papers/Issues/2017/05/19/pp032317state-contingent-debt-instruments-for-sovereigns>

⁴ Please see Appendix I below.

⁵ A list of these questions can be found in the Q1 presentation on the FMLC website [here](#).

- 7.1. Forum members agreed that the Secretariat should prioritise legal developments which, in the case of sovereign debt, tend to follow a country's crisis.
- 7.2. Participants believed that the Scoping Forum should collaborate with the IMF on an *ad-hoc* basis, only on topics of which the IMF has first-hand knowledge of issues, in order to maintain independence.
- 7.3. Forum members noted the following topics of interest that could potentially be included on the agendas of future meetings:
 - i. Green bonds;
 - ii. Pooled bonds;
 - iii. Social impact bonds;
 - iv. Commentary on the ranking of official vs private sector debt; and
 - v. Brexit issues under a sovereign context e.g. question of relevance of English law post-Brexit, and whether markets would be well-served by English law.
- 7.4. One participant suggested that, as discussion has largely focussed on technical issues, market perception may also be relevant.

8. Any other business

- 8.1. No other business was raised.

Operation of FMLC Working Groups



Venessa Parekh,
FMLC Acting Project Secretary

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Standing forums are convened quarterly to provide a space for exploration and discussion

FMLC

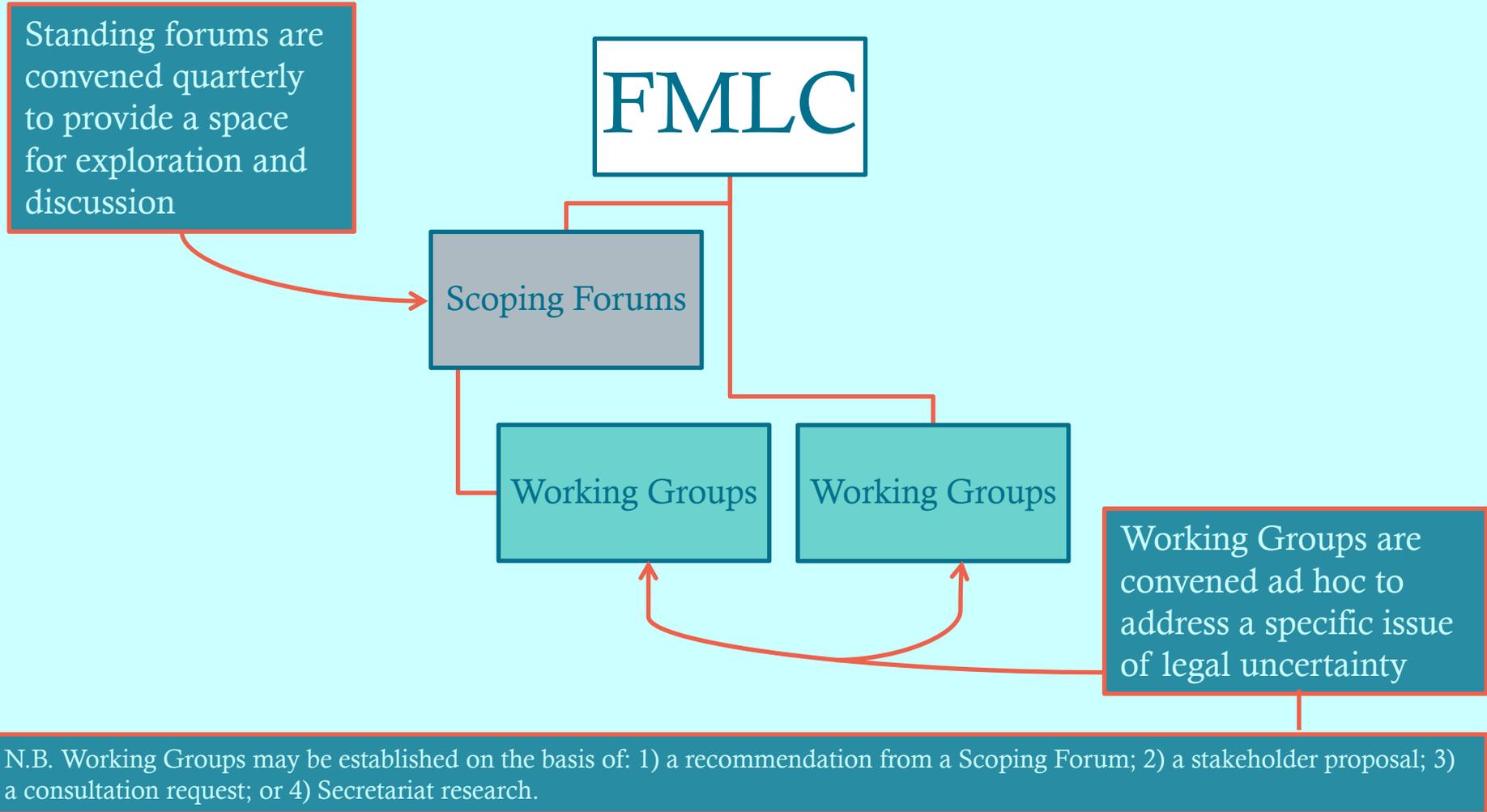
Scoping Forums

Working Groups

Working Groups

Working Groups are convened ad hoc to address a specific issue of legal uncertainty

N.B. Working Groups may be established on the basis of: 1) a recommendation from a Scoping Forum; 2) a stakeholder proposal; 3) a consultation request; or 4) Secretariat research.



Working groups: objectives

- The ultimate function of a Working Group established by the FMLC is to assist the Committee to address a specific issue of legal uncertainty by expressing an authoritative consensus.
- Pursuant to this aim and to the FMLC's remit, a Working Group will have the following objectives:
 1. to encourage discussion and the expression of a range of views;
 2. to build consensus that can be expressed in an FMLC publication; and
 3. to produce a draft publication to which, ideally, as many Working Group members have contributed as possible.

How are working groups initiated?

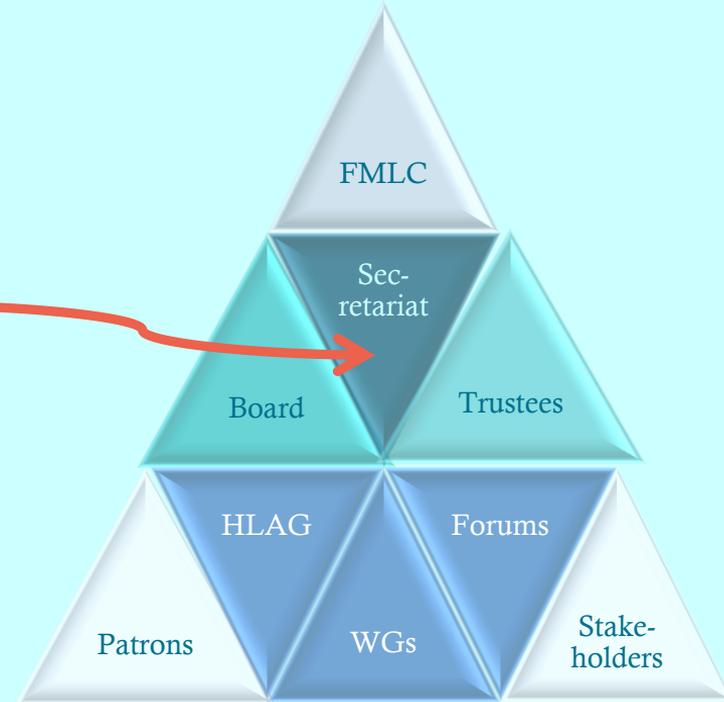
- Working Groups are established by the FMLC on the basis of a note specifying the relevant legal uncertainty (the “brief”).
- This brief defines the scope of work to be undertaken. It serves a threefold function:
 - to establish controls over the group’s output on behalf of FMLC Members;
 - to inform prospective contributors as to the scope of the project; and
 - to assist the Chair and Secretariat to allocate appropriate resources to the project, according to its expected size and complexity.
- In the case of work recommended by the members of a Scoping Forum or any other stakeholder(s), the brief should be prepared by the person or persons making the recommendation and put before the FMLC Committee for approval. (The FMLC Secretariat will normally offer formatting and other assistance in preparing the brief.)

Working groups: conduct of business

- Working groups are convened under Terms of Reference, including conduct of business guidelines. These include the following:
 1. to encourage a diversity of perspectives, Working Group participation is limited to one member per organisation;
 2. to ensure accountability and transparency, alternates are, as a general rule, not permitted to attend meetings; and
 3. to foster individual engagement, Working Group meetings are to be attended in person, where possible. (Accordingly, the FMLC Secretariat does not provide dial-in details for working group meetings unless a member is based abroad.)
- Work within the Group follows a schedule (“Milestones”) established at the inaugural meeting and implemented by the FMLC Secretariat.

Working groups: FMLC Secretariat

- The Secretariat supports the Chair and the Working Group during meetings, and manages Group-related communications outside meetings.
- The Secretariat helps draft and circulate meeting agenda and related documents in advance of Working Group meetings and takes minutes.
- Contributors are asked to send draft submissions to the Secretariat, whether directly or in copy.



Forum questions from previous meeting

- Assuming the FMLC has limited resources to devote to Sovereign Debt issues, in 2017, which are those that it should prioritise?
- Should the FMLC be collaborating with the IMF on ad hoc discussion forums?
- Does the Forum agree that the flow of information between members and the FMLC Secretariat should ideally be a 2-way process? How can the Secretariat best assist the Forum in its discussions?
- Does the Forum agree that the Secretariat should table updates for the Forum on issues which the FMLC considers relevant to the industry, although not a commercial priority (e.g. developments in other jurisdictions)?

Conclusion / The End



Financial Markets Law Committee

Communications@FMLC.org

+44 (0)20 7601 3272