



Financial Markets Law Committee (“FMLC”)

Sovereign Debt Scoping Forum

Date: Tuesday 4 June 2019

Time: 2pm to 3.30pm

Location: White & Case, 5 Old Broad Street, London EC2N 1DW

In Attendance:

Francis Fitzherbert-Brockholes (Chair)	White & Case LLP
Carter Brod	Morgan, Lewis & Bockius UK LLP
Emma Dickinson	Deutsche Bank
Leland Goss	ICMA
Ian Clark	White & Case LLP
Jim Ho	Cleary Gottlieb Steen & Hamilton LLP
Duncan Kellaway	Freshfields Bruckhaus Deringer LLP
Rosa Lastra	Queen Mary University of London
Yannis Manuelides	Allen & Overy LLP
Tolek Petch	Slaughter and May
Andrew Shutter	Cleary Gottlieb Steen & Hamilton LLP
Deborah Zandstra	Clifford Chance LLP
Venessa Parekh	FMLC

Guest Speaker:

Steven L. Schwarcz	Duke University School of Law
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Apologies:

Richard O’Callaghan	Linklaters LLP
Rodrigo Olivares-Caminal	Queen Mary University of London
Philip Wood QC	

Registered Charity Number: 1164902.

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Agenda:

1. Introductions

- 1.1. Mr Fitzherbert-Brockholes opened the meeting. He introduced Professor Schwarcz and thanked him for attending this meeting.

2. Administration: Elsewhere at the FMLC (Venessa Parekh)

- 2.1. Owing to technical difficulties, Ms Parekh did not deliver a short presentation on the FMLC's recent work.¹ She agreed to circulate the slides with the minutes of the meeting.

3. A framework for debt restructuring in the euro area (Rosa Lastra)

- 3.1. Professor Lastra provided an overview of the architecture which emerged after the 2008 financial crisis to deal with sovereign debt restructuring. This includes the European Financial Stabilisation Mechanism, the European Financial Stability Facility, and finally the European Stability Mechanism ("ESM"). Professor Lastra observed that the ESM, and the Treaty establishing it, have been found by many observers to be inadequate. Several proposals have emerged to replace it with either a similar body with amplified powers or an independent court or forum, within the European Court of Justice ("ECJ"). Professor Lastra then discussed the challenges that these proposals face. Expanding the ESM raises questions as to an overlap in its functions with those of the International Monetary Fund. There are concerns that it would be difficult to find the expertise to outfit a specialist team within the ECJ.
- 3.2. Next, Professor Lastra turned to sovereign bond backed securities ("SBBS")—securities backed by a diversified portfolio of euro area central government bonds—which had been proposed as a solution to help banks diversify their sovereign exposures. Professor Lastra noted, however, that although SBBS had been lauded by authorities, the current regulatory framework had impeded the development of a market for SBBS.
- 3.3. An attendee made an observation about the risks associated with SBBS, including the fragmentation of the security, the need to establish a special purpose vehicle, etc., which raised costs and concerns. Another attendee raised difficulties with the proposal that an amended-ESM replace the International Monetary Fund ("IMF"): the IMF's Article IV assessments of member countries' economies are considered the gold standard; assigning these functions to another body could raise concerns about credibility. Forum members

¹ See Appendix I.

briefly discussed the work of similar agencies in Asia and Africa which conducted debt sustainability assessments much like the IMF.

4. A model-law approach to sovereign debt restructuring (Steven Schwarcz)

- 4.1. Professor Schwarcz introduced his work developing a new bankruptcy/insolvency-type approach to sovereign debt restructuring. He noted that a more cumbersome type approach had been considered by authorities in the E.U. during the development of the IMF's proposed sovereign debt restructuring mechanism. Professor Schwarcz has developed a "model law approach" which would add much greater security—and could be pursued in parallel—to the contractual approach of collective action clauses ("CACs") or aggregated CACs. A model law approach would also circumvent political stasis as it could be enacted individually by countries, as their domestic law, without requiring a formal treaty.
- 4.2. Professor Schwarcz explained that his proposed model law attempts to solve the hold-out problem—i.e., situations in which minority creditors try to prevent a reasonable restructuring in order to get themselves a better deal. The model law allows the debtor-state to designate *pari passu* classes of creditors, modelled on the U.S. Chapter 11 bankruptcy-reorganisation approach. Professor Schwarcz then delved into the legal, political and economic feasibility of the model law approach. He explained that the model law, if enacted, could apply retroactively. This would not be a problem as long as the restructuring was not unfair to any class of creditors. Politically, the model law would only need to be adopted by one or more jurisdictions to be effective. This would be especially powerful if it were enacted into English or New York law because those laws govern the vast majority of sovereign debt contracts. Finally, previous iterations of proposals to reform the sovereign debt restructuring framework had been met by complaints that this would raise the cost of borrowing. Professor Schwarcz noted that recent empirical research shows that such a framework would make government debt less risky and actually lower the cost of sovereign borrowing.
- 4.3. A brief discussion followed on whether the model law would have to be enacted by a government to be effective or whether parties to a contract could select the model law as a set of rules to govern their contract, even if it hasn't been enacted by any state. Professor Schwarcz posited that the latter option should be possible, at least in part—i.e., parties could state that any debt restructuring associated with their sovereign debt contract would be conducted on the basis of the model law.

4.4. A question was raised about the interaction, in the U.K., of the model law with Regulation (EC) No 593/2008 on the law applicable to contractual obligations (“**Rome I**”). Another attendee questioned the use of the public interest argument to impose retroactively the model law on a sovereign debt restructuring. Professor Schwarcz responded that the *pari passu* class-voting protections of the model law should alleviate these concerns. He also observed that the retroactive application of the model law was not integral, though he and his colleagues hoped that it would be adopted in that manner. He also outlined plans for dialogue with relevant officials in New York State to consider enacting the model law as New York law. A Forum member also asked why the model law does not include a cram down provision. Professor Schwarcz responded that the model law currently omits cram down because applying that in a governmental debt-restructuring context would require determinations that would be complex, fact-intensive and highly politically sensitive. Even without cram down, the model law would still be a major advance over the status quo. If experience with the model law demonstrates that a cram down provision is needed, the model law could later include it.

5. Any other business

5.1. No other business was raised.

Did you know ..?

A quick glance at some FMLC numbers



Venessa Parekh

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Addressing legal uncertainty



Since 2003, the FMLC has analysed and made recommendations to resolve legal uncertainties in 222 disparate topics.

Solvency II
Brexit
E.U. Data Protection Reform
Market Abuse Regulation
EMIR
Emissions Allowances
Benchmarks Reform
Capital Markets Union
Sovereign Debt Collective Action Clauses
Bail-in
Rome I
Bank Reform (Ring Fencing)
International Coordination of Law and Regulation
Regulation of Credit Rating Agencies
MiFID II
Bank Recovery and Resolution
Financial Market Infrastructures
Virtual Currencies

FMLC research is conducted through:

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Scoping Forums

- Asset Management
- Banking
- Brexit
- Infrastructure
- Insurance
- Fintech
- Securities
- Sovereign Debt
- Quarterly Discussion Forum (closed)

4

Working Groups

... are currently active. Two deal with matters related to Brexit.

In order to be agile in its responses to Brexit statutory instruments, the FMLC did not establish Working Groups but liaised with relevant experts to conduct a review and publish its results.

FMLC Publications

16

publications were produced in 2018

8

publications were on the U.K.'s withdrawal from the E.U.

7

publications on the review of Brexit-related statutory instruments (between August 2018 to April 2019).

2018-Present FMLC Events



5

formal events were held.

12

guest speakers across all events.

85

guests attended the Autumn Seminar on Incorporating E.U. Law into the U.K. Domestic Framework, the most attended FMLC event of 2018.

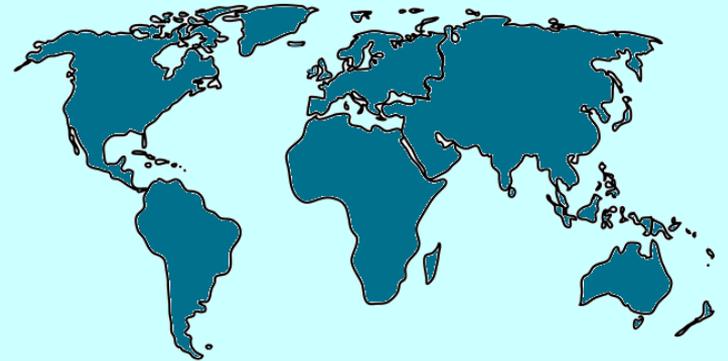
International connections

15 speeches were given by the FMLC CEO in 4 different countries

4 calls are held every year with the Financial Markets Lawyers Group ("FMLG") (New York)

3 sister organisations (associated with the Federal Reserve, the ECB and the Bank of Japan) participate in an annual conference with the FMLC

7 jurisdictions (E.U., Hong Kong, Japan, Switzerland, Singapore, U.K. and U.S.) hold a biannual information-exchange video conference



People and the FMLC

37 patron organisations

52 average number of members per Scoping Forum

28 Committee Members

24 average number of members per Working Group

8

staff at the FMLC Secretariat (including 2 staff members on maternity leave)

Looking under the hood ...

£396,000*

Projected 2019 budget

- Budget is accrued unevenly from donations by:
 - Bank of England
 - City Remembrancer's Office for the City of London Corporation
 - Association for Financial Markets in Europe
 - AIG Europe Limited
 - Lloyd's of London
 - Around 30 law firms
 - Other market participants

83%

Percentage of charitable income spent on Secretariat salaries

- £329,000.00* will be spent on Secretariat salaries in 2019.
- The rest of the budget goes towards administrative costs and inviting/funding foreign experts to share their expertise at the FMLC educational events.
- The Bank of England bears many of our overheads and is the largest donor when this is taken into account.

*All figures rounded to nearest £000

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