Financial Markets Law Committee (“FMLC”)

Sovereign Debt Scoping Forum

Date: Tuesday 16 June 2020

Time: 2.00pm to 3.30pm

Virtual meeting

Attendees:

Jim Ho (Moderator)	Cleary Gottlieb Steen & Hamilton LLP
Emilios Avgouleas	University of Edinburgh
Cater Brod	Morgan, Lewis & Bockius UK LLP
Ian Clark	White & Case LLP
Timothy DeSieno	Morgan, Lewis & Bockius LLP
Emma Dickinson	Deutsche Bank AG
Michael Doran	Baker McKenzie LLP
Francis Fitzherbert-Brockholes	White & Case LLP
Leland Goss	International Capital Market Association
Nicole Kearse	African Legal Support Facility
Rosa Lastra	Queen Mary University of London
Yannis Manuelides	Allen & Overy LLP
John McGrath	Dechert LLP
Toyin Ojo	African Legal Support Facility
Phillip Wood	
Deborah Zandstra	Clifford Chance LLP
Venessa Parekh	FMLC Secretariat
Chhavi Sinha	FMLC Secretariat
Katja Trela-Larsen	FMLC Secretariat

Guest Speaker:

Claude Brown	Reed Smith LLP

Regrets:

Duncan Kellaway	Freshfields Bruckhaus Deringer LLP

Richard O'Callaghan	Linklaters LLP
Rodrigo Olivares-Caminal	Queen Mary University of London
Harriet Territt	Jones Day

Minutes

1. Introductions

1.1. Mr Ho opened the meeting.

2. Linking in with the FMLC (Venessa Parekh)[1]

2.1. Ms Parekh provided an overview of a few non-pecuniary ways in which Forum members, or their institutions, could contribute to the work of the FMLC. These include contributing to research, hosting meetings and events and seconding lawyers to the Secretariat.

3. "Coronabonds": An E.U. Pandemic Solidarity Instrument (Claude Brown)

3.1. Mr Brown introduced himself. He opened by giving some headline figures based on predictions by the Organisation for Economic Co-operation and Development ("**OECD**") on the economic impact of the current coronavirus pandemic on the E.U. He stated the E.U. had, for the first time, suspended the Eurozone Stability and Growth Pact to allow for economic support measures in response to the coronavirus pandemic. The immediate fiscal support measures adopted by Member States ranged from 6% to 1% of their GDP, with an average of 3% of GDP. The pandemic prompted the European Central Bank ("**ECB**") to initiate a Pandemic Emergency Purchase Programme ("**PEPP**") in March 2020. Mr Brown commented that the pandemic has had an asymmetric impact on Member States owing to different economic starting points, different pandemic experiences and different impacts on the economies of Member States because of the weighting of different sectors within their economies (for example: manufacturing, retail, or tourism).

3.2. Mr Brown explained that there is no uniform proposal for an E.U. Pandemic Solidarity Instrument—he has based his presentation on a proposal by Lucas Guttenberg and colleagues (the "**Proposal**") and extrapolated some points.[2] The Proposal for a

[1] Please see Appendix I

[2] Centre for European Reform, *A Proposal for a Coronabond: The Pandemic Solidarity Instrument* by Christian Odendahl, Sebastian Grund and Lucas Guttenberg (6 April 2020), available at: https://www.cer.eu/insights/proposal-coronabond-pandemic-solidarity-instrument

"Coronabond" suggests a one-off instrument of €440 billion issued by an unspecified "E.U issuer" which would not be limited to the eurozone, but would cover the entire E.U. The issuance would be backed by irrevocable, unconditional guarantees from all Member States, with repayment at maturity made by each Member State proportional to its share of the E.U.'s GDP at the maturity date. Mr Brown outlined the suggested allocation of funds in the Proposal.

3.3. The legal basis for the proposed instrument stated in the Proposal is Article 122(1) of the Treaty on the Functioning of the European Union ("**TFEU**"), which allows the European Commission to propose and the Council to decide "in a spirit of solidarity between Member States, upon the measures appropriate to the economic situation". Mr Brown commented the proposal also hinges on the challenge of wording in Article 125 (1) of the TFEU where Member States and the Union:

> shall not be liable for or assume the commitments of central governments, regional, local or other public authorities other bodies governed by public law, or public undertakings of another Member State, *without prejudice to mutual financial guarantees for the joint execution of a specific project*[3] (emphasis added)

The proposal specifically states it is not based on Article 122(2) of the TFEU, which was used during the euro crisis, as it goes beyond financial assistance such as loans. Article 122(1) gives the E.U. wide discretion to act "in the spirit of solidarity". The obligation in Article 310 TFEU that the E.U. must always balance its books can be overridden by Article 311. This states that the EU "shall provide itself with the means necessary to attain its objectives and carry through its policies ", which the Proposal suggests should include debt that is guaranteed by the Member-States.

3.4. Mr Brown listed some other variations of "Coronabond" proposals including: "Recovery bonds" where the proceeds would be used for future investment; "Coronabonds" with repayment guaranteed by E.U. budget; Member States pledge tax revenues to repay bonds; increased issue size of € 1,000 billion; or capping issue size and limiting application of the funds to coronavirus related expenditure. Other options proposed to provide fiscal support against the effects of the pandemic include: use of the European Stability Mechanism ("**ESM**"), an European Investment Bank ("**EIB**") pan-E.U. guarantee fund of €25 billion from Member States to guarantee €200 billion of loans to SMEs, a proposal by the European Commission of a new instrument for temporary Support to mitigate Unemployment Risks

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3 Article 125 (1) of the Treaty on the Functioning of the E.U. (TFEU)

in an Emergency ("**SURE**") to make €100 billion in loans to Member States to support unemployment payments and furlough/short work schemes, repurposing of the 2021-2027 Multiannual Financial Framework to form "a Marshall Plan" for the E.U., and a permanent fiscal capacity at Economic and Monetary Union ("**EMU**") level to issue permanent safe assets.

3.5. Mr Brown highlighted a number of issues for use of the ESM and "Coronabonds", including that the ESM would only cover the eurozone, it is unclear who the issuing entity for "Coronabonds" would be and guarantees require parliamentary approval in some Member States. In relation to the requirement for parliamentary approval of guarantees, Forum members discussed the judgment issued by the German Federal Constitutional Court on 5 May 2020 on the legality of the ECB's decisions on the Public Sector Purchase Programme ("**PSPP**").[4] A member shared a link for a European Parliament report on the ECB mandate and the interaction between the primary objective and the secondary objectives, as well as the relationship between Articles 125(1) and 122 of TFEU.[5]

4. Institute of International Finance and the G20 Debt Service Suspension Initiative (Deborah Zandstra)

4.1. Ms Zandstra drew members' attention to a G20 communiqué, explaining that the document sets out work streams and financial measures aimed to overcome the raft of social and economic issues which have arisen owing to the pandemic. One of these measures is the G20 Debt Service Suspension Initiative ("**DSSI**"), also agreed by the Paris Club, in which official bilateral creditors will participate.[6] The idea behind the initiative to support countries' payment capacity by providing temporary assistance, if needed, for diverting resources to emergency COVID-19 response. A successful application of the DSSI will result in suspended payments due this year. She stated that Annex II of the G20 communiqué sets out the common Term Sheet providing the key features for the DSSI. The G20 reached out to the Institute of International Finance ("**IIF**") about the initiative and whether, in view of

4 BVerfG, Judgment of the Second Senate of 05 May 2020—2 BvR 859/15

5 European Parliament: Policy Department for Economic, Scientific and Quality of Life Policies, *The ECB Mandate: Perspectives on Sustainability and Solidarity* (May 2020), available at https://www.europarl.europa.eu/cmsdata/207720/Lastra-Alexander_FINAL%20online.pdf

6 G20, *Communique: G20 Finance Ministers and Central Bank Governors Meeting 15 April 2020 [Virtual]* (April 2020), available at: https://g20.org/en/media/Documents/G20_FMCBG_Communiqué_EN%20(2).pdf

the official sector DSSI, the private sector could provide a contribution. The IIF agreed to coordinate the response to this call.

4.2. Ms Zandstra stated she has been "holding the pen" on this for the IIF. The IIF's Committee on Sovereign Risk Management has been a leading forum to facilitate discussions between the official and private sectors on voluntary participation in the DSSI, convening over 100 industry officials. Ms Zandstra reported a large part of the engagement has been clarifying technical issues, as proposals need to work within the framework of the underlying contractual documentation, and exploring the potential unintended consequences of private participation in the DSSI. Potential consequences to be considered include the possibility of rating downgrades. The IIF have met with credit rating agencies which have confirmed there almost inevitably will be downgrades in the short term. This work has led to the creation of a private sector Terms of Reference for voluntary participation in the DSSI.[7] The Terms of Reference are designed to function as a flexible template that can be used as a starting point to advance individual conversations between sovereign borrowers and their private creditors.

4.3. Members discussed Net Present Value ("**NPV**") neutrality, anecdotal reports that the initiative has caused some confusion and led to credit rating agency downgrades. Ms Zandstra noted the IIF has received a number of communications from Non-Governmental Organisations and the United Nations asserting that more action should be taken by the private sector. She voiced her personal opinion these responses failed to acknowledge fully that the existing structures of debt issuance give rise to certain limitations. Members agreed the decision by countries on whether to ask for suspension from some or all of their creditors will need be made on an individual country-by-country basis.

5. Barbados' sovereign debt restructuring—a case study (Jim Ho)

5.1. By way of background, Mr Ho explained that Barbados' economy was severely impacted by the financial crisis. He stated comprehensive debt restructuring was announced by the new Barbados government in June 2018. This restructuring took place in two stages, following engagement with committees of creditors. Firstly, the restructuring of instruments denominated in domestic law and Barbadian Dollar ("**BBD**"), including treasury bills and arrears, was undertaken until November 2018. Secondly, USD-denominated debt governed

7 Institute of International Finance, *Terms Of Reference for Voluntary Private Sector Participation in the G20/Paris Club Debt Service Suspension Initiative ("DSSI")* (28 May 2020), available at: https://www.iif.com/Portals/0/Files/content/Regulatory/Voluntary%20Private%20Sector%20Terms%20of%20Reference%20for%20DSSI_vf.pdf

by English law, New York State law and domestic law was restructured in late 2019 and early 2020. As a result of the 2018-2019 restructuring, Barbados is now the only country in the world with a climate-resilient public debt stock.

5.2. Mr Ho stated "Natural disaster clauses"—also known as "hurricane clauses"—are a feature used in sovereign debt instruments which provide for a temporary moratorium on principal and interest payments in the event of an insured natural disaster affecting the sovereign issuer. These clauses are used by sovereign issuers to hard wire debt relief in the event of a natural disaster, rather than relying on post facto restructuring to mitigate losses. The clauses were first used in Grenada in 2015. The International Capital Market Association ("**ICMA**") published a model clause in 2018, and most recently Barbados included the clause in new instruments following the 2018-2019 restructuring. The payment moratorium can either be structured as a deferral of each interest and amortization payment by a specified time period—as in ICMA's model—or a period of time during which no payments are made, following which the remaining scheduled payments are increased *pro-rata*—as in Grenada and Barbados.

5.3. In the Barbados restructuring, the concept was developed from the Grenada and ICMA precedents. Mr Ho went through a number of innovations which were added, including expanding the trigger events to include earthquakes and floods in addition to tropical cyclones (the Grenada and the ICMA model included only tropical cyclone events). A member queried how the bonds might be priced. Mr Ho commented that the capacity of the market to price such instruments continues to evolve.

6. Any other business

6.1. No further business was raised.

Linking into the work of the FMLC

FINANCIAL MARKETS LAW COMMITTEE

Venessa Parekh

Research Manager

Non-pecuniary involvement with the FMLC

The FMLC's work in furthering legal certainty in the wholesale financial markets, addressing legal risk, and providing impartial analysis is vitally important at this time when so much is happening.

The FMLC appreciates your support through participation in this Scoping Forum. Do you know other ways you can engage with and contribute to the FMLC, aside from a monetary donation?

Engaging with the FMLC

- Alerting the FMLC Secretariat to issues of legal uncertainty
- Participation in FMLC scoping forums, either as a member or a guest speaker
- Joining FMLC working groups, contributing legal expertise and drafting chapters of papers
- Participation in FMLC events, either as a attendee or guest speaker

Supporting FMLC Events

Your organisation can host FMLC events and/or provide logistical support for events, such as printing.

For example:

- Judicial Seminar
- Quadrilateral Conference
- Spring and Autumn Seminars
- Patrons' Dinner, and
- Festive drinks reception

FMLC Secondment Programme

Law firms can supply lawyers on secondment to the FMLC Secretariat, in the role of Legal Analyst.

The secondment provides an opportunity to conduct detailed research on specific issues and will hone key skills such as drafting, legal research and stakeholder relationships.

Each secondment typically lasts for a period of 6 months. Recent secondees have included trainee solicitors and associates at NQ level, as well as associates who are one year or more PQE.

Supporting the FMLC

If you wish to find out more about the FMLC secondment programme and how your organisation can participate, please contact Emma McClean (operations@fmlc.org)

If you wish to find out more about upcoming FMLC events and the ways you can offer support, please contact Rachel Toon (executivesupport@fmlc.org)

If you have an issue of legal uncertainty you would like to raise with the FMLC, or if you or your organisation would like to contribute to the FMLC's work via a Scoping Forum or Working Group, please contact Venessa Parekh (research@fmlc.org) or Katja Trela-Larsen (forums@fmlc.org)