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SOME PRIVATE SECTOR VIEWS ON COUNTRY DEBT RESTRUCTURINGS

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Michael M. Chamberlin
Executive Director, EMTA

This may date me, but in the sovereign debt restructurings that I am most familiar with, great efforts were made to obtain the participation of creditors holding 95% or more of the outstanding debt, for purposes both of maximizing the economic benefits of the restructuring and of minimizing ongoing litigation risk. The basic purposes of those restructurings, which occurred in the somewhat simpler world of predominantly commercial bank lending, was generally to reduce the country's debt burden so that, among other things, its resources could be redirected to other uses, debt service could be brought current, creditor relations could be normalized and the country could return to the voluntary markets.

Things have worked somewhat differently ever since bonds replaced commercial bank loans as the primary component of Emerging Markets finance.

Almost two years ago now, Argentina restructured about 76% of its over $80 billion in outstanding bonds, which had been in default since December 2001. Since then, its economy and FX reserves have rebounded and it has repaid its IMF outstandings. Most of this economic and financial progress came during a time of massive inflows into the EM asset class, and while Argentina was successfully resisting efforts by various creditors to locate assets and enforce judgments in excess of $1 billion.

There is little that can be said about Argentina's economic difficulties, default and restructuring that everyone will agree with, other than that the whole situation was deeply unfortunate and that it in some way highlighted the lack of consensus about country debt restructurings. Many investors, for example, have sharply criticized Argentina's restructuring tactics, which involved what can fairly be described as a "take-it-or-leave-it" offer, at a time when many believed (particularly with the benefit of hindsight) that Argentina could have offered its creditors more generous restructuring terms. Other investors (some pointing to the subsequent performance of Argentina's GDP instruments and other assets offered in the restructuring) have criticized the so-called 'hold-out' investors for not participating and, in effect, for not simply 'moving on'.

In the past decade or so, since shortly after the Mexican 'Tequila' crisis, there has been much debate about international financial architecture, whether or not there are 'holes' in it, and if so, how to fill them. Much of this debate has been overblown, and has focused on perceived 'demons' such as 'rogue' creditors, 'rogue' debtors and even 'rogue' international financial institutions.

Over the course of 2006, beginning on June 7 and continuing on October 5, October 12 and December 6, EMTA presented four panel discussions relating to various aspects of what we called "Partial Sovereign Restructurings". The purpose of these panel discussions was not to take sides in the debate about Argentina's restructuring, or to attempt to develop any sort of consensus EMTA position on any of the questions raised by recent restructurings, but simply to explore the lessons, if any, that can be learned from recent experience, an experience that has been difficult for all concerned, and for the market in general.

Panelists included a number of leading lawyers representing investors and debtor countries, officials from the United Nations and a G-7 central bank, several prominent investors, a leading academic in the area of Emerging Markets finance and representatives from two different rating agencies, and the audiences included a wide range of lawyers, investors, sellside representatives and government officials. The four panels were introduced and moderated, respectively, by Jim Kerr (Davis Polk), Michael Straus (Straus & Boies), Andrew Yianni (Clifford Chance) and Whitney Debevoise (Arnold & Porter). Each panel presentation featured extensive interaction among panelists, as well as between panelists and members of the audience.

From these presentations, the following observations can be drawn:

(1) <u>Ratings agencies may have quite different policies on how to treat sovereign debtors that are in, or emerging from, default scenarios, and in particular, they may have differing views on the relative importance of capacity and willingness to pay.</u>

The starting point in several of EMTA's presentations was a description of the approach to recent sovereign restructurings taken by rating agencies, and it is apparent that the various rating agencies are not necessarily consistent in this regard.

Ratings agencies generally seem to agree with most of the investor community that there are two components of sovereign creditworthiness—capacity and willingness to pay, but they disagree with each other about their relative importance.

In its approach toward Argentina, for example, Standard & Poor's has taken a fairly pragmatic and forward-looking view that, although Argentina's recent track record does bear on its willingness to pay, Argentina's current rating of B reflects S&P's view that it is no longer particularly meaningful to put much weight on Argentina's default or on the potentially disruptive effect represented by Argentina's untendered bonds. This is in part because of S&P's judgment that, even if collection efforts were successful (to date they have not been), Argentina's public finances were unlikely to be disrupted and it has sufficient resources to meet its obligations. Though the S&P representative at EMTA's June 7 panel presentation declined to discuss specifically whether or not there were any qualitative factors that in their view would effectively impose a ceiling on Argentina's rating should its economy continue to improve, she did concede that, in the long history of sovereign debt default and restructuring, "partial or complete repudiation was not without precedent".

At EMTA's October 12 meeting, a Fitch representative described their somewhat more conservative approach (maintaining a general rating for Argentina of RD—restrictive default) as involving a judgment that, despite various positive economic factors, Argentina's default had not been fully resolved (unlike prior defaults by Uruguay and the Dominican Republic, where RD ratings had been removed within several months after their respective debt exchanges). Asked by a public sector official why Fitch gave such weight to the process followed by Argentina in restructuring its debt, and instead did not just consider the outcome, the Fitch representative explained that, in their view, process mattered because it revealed something about a debtor country's attitude toward property and creditor rights. The panelist from Fitch further explained that they would be prepared to change the RD rating if either Argentina were to launch a new exchange offer for 'hold-out' creditors that was "broadly accepted" or if it resumed normal bond financings in the international capital markets without incurring the risk that proceeds or debt service would be attached by the 'hold-outs'. He declined to specify what specific participation level would satisfy their standard of broad acceptance.

The discrepancy in views between these two rating agencies probably is mirrored in a certain inconsistency of investor views regarding the significance of a debtor country's track record in servicing its debt. This inconsistency certainly can be seen in current investor attitudes regarding Argentina.

(2) <u>Creditor participation levels in sovereign restructurings may or may not have declined from the 95%+ critical mass levels of the Brady and pre-Brady era.</u>

Participation levels in the 1980's and early 1990's tended to be above 95%, and often approached 100%, as debt restructurings were generally heavily negotiated between debtor countries and their bank advisory committees and the international financial institutions and bank regulators encouraged the parties to reach a very high 'critical mass' of participation. A number of factors, including concerns about the greater diversity of bondholders, and potentially greater difficulties in obtaining their acquiescence, as well as the resulting G-7 government support for 75% collective action clauses, have contributed to a perception that participation levels in future sovereign restructurings may be sharply lower than in the past. The relatively low bondholder participation rate of 76% that resulted from Argentina's restructuring tactics was consistent with this perception, and has in turn raised concerns among many investors that other sovereigns may be encouraged to adopt similar restructuring strategies.

Several panelists in the EMTA presentations expressed views to the effect that, while the acceptable participation rate for sovereign bond restructurings is debatable, lower participation rates in future restructurings are inevitable. Factors that tend to drive down creditor participation rates include diversification of bondholders, changes in the restructuring process, debtor restructuring tactics and low carrying costs, with one implication being greater potential for, and possible a greater tendency toward, more litigation.

Regardless of the factors that led G-7 governments to encourage the market to adopt the 75% CAC's that are now routinely included in new bond issues, the many prior bond issues that do not include such CAC's will probably require that, for the foreseeable future, most country debt reschedulings continue to be structured in the form of exchange offers. Whether or not debtor governments choose to emulate Argentina's take-it-or-leave-it restructuring tactics remains to be seen, and may in fact depend on the endplay of Argentina's restructuring, and in particular, whether 'hold-out' creditors are successful in enforcing their untendered bonds or whether, and if so how, Argentina chooses to reopen the terms of its exchange offer.

Although these investor concerns about restructuring strategies that will lead to low participation rates in future restructurings are generally consistent with the strain of populism that is prevalent in some EM countries and may yet prove to be well-founded, it is too early to draw firm conclusions one way or the other, and it may, in any event, prove misleading to view this question through what is essentially an Argentine prism. Each debtor country that determines that a restructuring of its debt is necessary will likely do so in the context of its own particular facts and circumstances. Belize, which recently completed the restructuring of its debt with an announced participation rate of over 98%, signaled early on that its restructuring would be creditor-friendly. Compared with Argentina, that establishes a wide bid/offer in restructuring styles and participation rates, and at this point, there is no more reason to assume that other debtor countries will follow the Argentine model than the Belizean one. Presumably, future restructurings will be guided less by populism than by a practical balancing of the degree of debt relief needed with the benefits of early return to the normally functioning voluntary markets.

(3) <u>Country debt restructurings are more likely to occur now than previously in an environment where there is pending litigation against the sovereign.</u>

Three of the four EMTA panel presentations focused largely on recent developments in the litigation of claims against sovereign debtors either during or after a restructuring, and several panelists emphasized that the role of the courts in connection with sovereign debt restructurings is likely to continue to increase. Why this has been the trend in recent years, and why that trend is believed to be on the increase, is not entirely clear, but the most obvious explanations come from quite different perspectives—<u>first</u>, that hardball restructuring tactics tend to precipitate litigation, and <u>secondly</u>, that the lack of collective action clauses in many bonds has combined with the greater diversity of holders to make it more likely that legal actions will be brought. It should come as no surprise that the first explanation is more often offered by investors, while the second is usually heard from the official sector. The most difficult problem with the second explanation, at least inasmuch as it applies to future trends, is that the increased litigation to date has been accompanied by a growing perception among investors that litigation against sovereign debtors has become much more difficult in recent years—despite the spectre of the rogue creditor, there are still very few examples of plaintiff creditors actually collecting judgments against sovereign debtors (see (5) below).

Of course, litigation against a sovereign debtor by a creditor was extremely rare during the Brady and pre-Brady eras, perhaps because most creditors were commercial banks subject to some influence by their bank regulators and supervisors or because most restructurings at the time were heavily negotiated and supported by IMF, which at the time was encouraging very high-percentage critical masses.

Beyond these more obvious explanations for the recent increase in litigation against sovereign debtors, there may be more subtle ones, such as the possibility that the low-interest environment that has prevailed for several years has sufficiently reduced the cost of carrying non-performing assets to make the business strategy of buying assets for the purpose of enforcing them more viable. It may also be that now that the taboo against bringing legal actions against sovereign debtors has been broken a number of times, investors have become more willing to be seen to be aggressive in enforcing their rights.

(4) <u>Predictably, there is a significant split in perceptions between investors and debtor countries regarding whether or not the US Foreign Sovereign Immunities Act is working properly, or as originally intended.</u>

The enforcement of claims against foreign sovereigns in the United States is subject to the limitations of the Foreign Sovereign Immunities Act of 1976, which endeavors to strike a balance between the rights of the debtor and its creditors. Following a discussion of the litigation risks faced by a debtor country that had only partially restructured its outstanding indebtedness, several of the June 7 panelists (lawyers representing debtors, as well as those representing creditors) agreed that there were "high hurdles" to the enforcement of judgments in the US courts under the FSIA. The main purpose of the October 5 panel was to outline the origins and purposes of the FSIA, and then to review in greater detail recent developments in its application in an effort to determine whether the FSIA, as interpreted, struck the appropriate balance between the rights of debtors and creditors.

Predictably, many investors (and their lawyers) believe that the original purpose of the FSIA was to make enforcement of claims against sovereigns more predictable and, to a certain extent, easier. These same investors tend to feel that recent developments in the courts have shifted the balance too far in favor of the debtor countries. On the other hand, lawyers for debtor countries contest that the original purpose of the Act was to make enforcement against sovereigns materially easier, but concede that perhaps it instead was intended to make the determination of sovereign immunity less political, by defining legal standards instead of leaving such determinations in the US solely up to US State Department officials.

While it is not surprising that lawyers for investors believe that the balance has shifted in recent years toward the rights of debtors, and that lawyers for debtor countries believe that the balance is "just right", there is something about these sharply contrasting views that suggests that debtors are getting the results that they want under the FSIA, while investors are not. Somewhat more 'neutral' lawyers point out that several recent court decisions have appeared to narrow the concept of "property used for a commercial activity in the US", thus increasing the degree of immunity afforded to their property under the FSIA. Lawyers who make their living representing debtors deny that this trend is inconsistent with the original purposes of the Act.

Lawyers who mainly represent creditors make an interesting point. While they readily agree that one of the original purposes of the FSIA was to "de-politicize" the granting of immunity to foreign sovereigns in the US courts by taking such determinations away from the state Department and thereby to make the judicial process more transparent and objective, they contend that the recent reliance by the courts on so-called <u>amicus curiae</u> (or friend of the court) briefs submitted by the Executive Branch tends to undo the objective approach that the FSIA was intended to establish by re-injecting an element of arbitrary governmental policy.

(5) <u>Despite different views on other issues, there is virtual unanimity that it is much easier to obtain a court judgment in the US than it is to enforce one there.</u>

In the course of the EMTA panel presentations, lawyers for both debtors and creditors tended to agree on one thing—that it was much easier to obtain a court judgment against a sovereign in the US courts than it was to enforce one. A prominent lawyer for debtor countries conceded that it was "difficult, though not impossible to collect" under the FSIA. Not only do debtors tend to win enforcement cases much more often than creditors, but in the words of another relatively moderate lawyer, "if the scorecard for recent enforcement actions was running ten to one in favor of the sovereigns, each successful action by a creditor probably represents a mistake by the sovereign that is unlikely to be repeated."

Although there is no mechanism to ensure consistency of outcome between the US and the UK, the effect of sovereign immunity is generally comparable between the two jurisdictions.

While the distinction between obtaining a judgment and enforcing it may not previously have been appreciated widely by the investor community, presumably it now is.

Much of the difficulty that creditors have had in enforcing judgments against sovereigns in the US courts have been as a result of recent decisions denying the attachment of various types of property in the US because it was found not to be "used for a commercial activity in the US". In this regard, a prominent litigator on behalf of debtors observed that "Congress had not intended to give creditors the same remedies against foreign states that they had against private commercial entities".

Of course, debtors have had to go to some lengths to avoid enforcement actions against them in the US and elsewhere, most often by making sure that their assets cannot easily be found within jurisdictions where they can be attached. At EMTA's October 5 presentation, a panelist who represents both debtors and occasionally creditors observed that "there was nothing particularly wrong with it being difficult to enforce judgments in the US, as it very much depended upon where the sovereign's assets were located." In her view, the more accurate question was whether it should be easier to enforce US judgments against sovereigns in other jurisdictions.

The effort by debtors to avoid attachments to satisfy outstanding judgments has been partly responsible for driving the financing activities of such debtors back inside their own borders by preventing them from raising debt capital in the international capital markets. This forced retreat from the usual debt markets for some debtor countries has come at a time when high commodity prices have enabled many debtor countries to pay down much of their external debt and when enhanced liquidity in the capital markets generally has created a greater international investor appetite for local currency assets that has enabled many debtors to shift their financing activities from external currencies to their own.

(6) <u>At the same time, there is a significant spectrum of private sector attitudes, and even split views within the investor community, regarding whether or not the existing international financial architecture is adequate in balancing the interests of debtor countries and their creditors.</u>

While it is not surprising that lawyers for debtors generally disagree with lawyers for investors about whether the existing international financial architecture adequately balances the interests of debtors and creditors, there are somewhat unexpected disagreements <u>within</u> the investor community about how and when creditor rights should be asserted and how far creditors should go in protecting their interests.
In this regard, many investors presumably chose not to accept the terms of Argentina's restructuring because they believed that Argentina unfairly offered less than it could afford to pay, while other investors who did accept Argentina's exchange offer strongly feel that the 'hold-outs' tried to spoil, and ultimately delayed, the offer for those who wished to accept it, and then "missed the boat".

These views are strongly held and difficult to reconcile, in part because they do not appear to result solely from the experience of Argentina's restructuring or to exist solely in the context of a single investment scenario. Some investors seem more inclined than others to approve of offensive actions taken by creditors (as opposed to more passive or defensive ones) that could interfere with the flexibility of creditors generally to enter into restructurings or other transactions with debtors. In fact, the divide between investors seems to extend almost to the point where some investors care passionately about the enforceability of their rights under bond legal documentation, while others seem almost not to care whether or not their bonds are enforceable.

(7) <u>The prevailing view among investors, and most likely throughout the private sector, is that G-7 governmental policies are somewhat more in favor of debtor</u>

countries, and less in favor of creditor interests, than they were a decade or more ago.

Despite these sometimes conflicting views among investors about whether the rights of sovereign debtors and their creditors are adequately balanced, and how far creditors should be permitted to go to assert their rights, there does seem to be a fairly strong consensus within the investor community, and probably more broadly throughout the private sector, that there has been a significant shift of G-7 sentiment over the past 10 to 12 years in favor of sovereign debtors and against their creditors. This trend probably traces back to the early 1990's when, with the increasing securitization of EM debt, came a growing sense that the traditional approach of the official sector toward supporting EM restructurings needed to be reviewed.

Shortly after Mexico's 'Tequila' crisis of 1994-95, wary of the potential cost and perceived moral hazards of large-scale, so-called 'bail-out' packages, a series of official sector statements and initiatives focused attention on the appropriate role of the private sector in resolving sovereign financial crises, or what many in the official sector called 'burden-sharing' and some in the private sector referred to as 'burden-shifting'. By 1997, it had begun to become clear that official sector support for EM countries in crisis was falling short of market expectations. In its 1998 Annual Report, EMTA cautioned that, although rescheduling bonds may sometimes be necessary, any policy that emphasized bond rescheduling over the need for EM countries to take measures to avoid them was likely to drive investors away. By 2000, Ecuador had successfully completed a not altogether amicable restructuring of 97% of its bonds (in the memorable words of an EMTA buyside director at the time, "the result wasn't too bad, but the process sure stunk"), and in late 2001, of course, Argentina defaulted and the IMF launched its SDRM proposal, on the stated assumption that a mechanism was needed to ensure that 'hold-out' creditors could be compelled to participate in restructurings.

Before Argentina, there was a widespread perception throughout the official sector that the presumed 'hole' in the international financial architecture was the potential that a 'hold-out' or 'rogue' creditor would not participate in a restructuring and might in fact disrupt it. This perception was generally consistent with the prevailing official sector philosophy of 'burden-sharing' (ie, that bondholder restructurings should be facilitated so that the private sector shared with the official sector the burden of resolving sovereign financial crises), but largely seemed to stem from the relatively isolated experience of Elliott Associates v Peru, in which hedge fund Elliott in late 2000 collected about $58 million in settlement of a judgment relating to Peru debt purchased at a deep discount in 1997. The potentially disruptive effect of this precedent on future restructurings, as well as the context of the settlement (Elliott managed to obtain restraining orders against several clearing agencies, thus effectively preventing Peru from making interest payments on other debt issues and pitting one creditor against others) ultimately led to a series of official sector proposals designed to fill this perceived 'hole'.

Although the SDRM proposal was eventually withdrawn in favor of the more or less voluntary acceptance by the markets of so-called 'collective action' clauses, it seems fair to say that many investors, as well as others in the private sector, felt that G-7 policy had shifted in favor of debtor countries and that Argentina's 'take-it-or-leave-it' approach to its rescheduling was generally supported by the official sector.

(8) <u>Though there are many shared criticisms of official sector policies and actions, there is no apparent consensus view among investors regarding the appropriate role of the official sector in resolving sovereign financial crises.</u>

If there is consensus within the private sector, more or less, to the effect that recent G-7 policies have inclined more toward EM countries than their creditors, that consensus does not carry over to any clear sense of what role the official sector should take in resolving sovereign financial crises.

Many in the private sector share the predominant official sector view that large-scale 'bail-outs' create moral hazards (for both creditors and debtors) and should therefore be avoided (even if most in the private sector dispute that such 'bail-outs' were actually as costly as many in the official sector seemed to believe). Nevertheless, most in the private sector believe that avoiding 'bail-outs' should not be an important policy goal in and of itself. Under some circumstances, they may be necessary and desirable in the public interest, regardless of any possible negative effects.

Official sector promotion of the SDRM was clearly perceived, throughout the private sector, as an over-reaction by the IMF and other SDRM supporters to the perceived dangers of 'rogue' creditors. There is a split in the investor community about the wisdom of 'collective action' clauses, more or less along the fault line described in (6) above. Several years ago, there was consensus in the private sector that the IMF's Lending into Arrears policy was inadequate (and being misapplied even under its own standards). There is widespread recognition within the private sector of the constraints faced by the IMF in its ability to influence the policies of EM countries, and that those constraints have gotten larger and more obvious as large EM debtors to the IMF have repaid their credits. There has been widespread dissatisfaction at various actions and policies of the Paris Club, despite its recent efforts to become more transparent in its activities.

In the United States, as noted above, there is a sense among many investors, though by no means all investors, that the FSIA, as recently interpreted and applied, no longer strikes the appropriate balance between sovereign debtors and their creditors. Whether that sense will ever catalyze a serious effort to revise the FSIA accordingly is very uncertain. Several years ago, in fact, an effort by an American Bar Association subcommittee to revise the FSIA to make it somewhat more <u>debtor</u>-friendly was nearly successful.

As expressed at several of the EMTA presentations, there is also some sense among many investors, again not among them all, that the US government has sometimes been too quick to intervene in legal actions (and in favor of the wrong side) through the <u>amicus curiae</u> mechanism, and that judicial process in the US has at times been too deferential in response. One EMTA panelist observed that, in his view, "the motives, interests and influence of the US government may at times be inconsistent with the general intent of the amicus curiae mechanism. The courts are now too heavily influenced by such government views, to the point where the predictability of outcome intended under the FSIA is too often trumped by government policy." Another EMTA panelist was somewhat blunter, stating that the US government should intervene in litigation against sovereign debtors, but "not on the wrong side". This comment was perhaps made mindful of the powerful amicus brief submitted by the US government in the 1984 Allied Bank case, in which the government argued that, although US policy placed great weight on the voluntary participation of private sector creditors in sovereign debt restructurings, such voluntary participation depended on creditors having enforceable legal documentation.

In addition, critics of recent official sector policies have criticized the US government for recent actions (including such things as amicus briefs, support for CAC's and pressure on the IMF to violate its own Lending into Arrears policies) that have generally tended to "undermine market discipline on Emerging Markets debtors" by depriving default of its consequences.

Of course, these various investor views, though strongly held, do not amount to a consensus, and they in any event are to a certain extent counterbalanced by the contrary views of debtor countries and their representatives.

Despite these perspectives in the private sector about things that the official sector should not be doing, there is little remotely approaching consensus that has been expressed at any EMTA presentation, or that I am otherwise aware of, about what the official sector should be doing with respect to financial crises in the Emerging Markets, other than trying harder to prevent them. Even where there have been strong private sector views in the past, the inability of the private sector to speak in a unified voice has diluted its influence on official sector policies in all but the most extreme cases.

Though I know very little about views within the official sector, one of the more enduring legacies of Argentina's restructuring may be that some of the uncertainties within the private sector about the appropriate role of the official sector now seem, to a certain extent, to be shared by some in the official sector. One official sector representative, carefully offering only his personal views, suggested that, in part as a result of Argentina, the official sector generally recognized that it was "limited in what it could do to influence events and outcomes" and accordingly had gained a better appreciation of the diversity of the investor community and had become "much more modest about what it could or should do to help resolve sovereign financial crises". Another official sector representative, also speaking as an individual, stated that "neither market discipline nor recent official rescheduling practices seemed to be working very well". In particular, she noted that something needs to be done about the relationship between the IMF and the Paris Club if the "right signals" are to be sent to the markets and that some IMF and Paris club policies, which she characterized as a "flaw in the current international financial architecture", had succeeded in turning liquidity problems into solvency problems.

(9) The ability to make accurate judgments about the efficacy of the current international financial architecture is affected by the current economic and investment climate, which has been characterized by high commodity prices and resulting accumulation of reserves and reduction of debt levels by debtors, substitution of local currency financing for financing in external currencies and generally high levels of liquidity.

During EMTA's panel presentations, several speakers noted the inability of market forces to impose much in the way of discipline on sovereign debtors under current market conditions, in the absence of stronger enforcement rights. Just as the favorable economic environment has bolstered the performance of Argentina's economy, it may also have made investors generally less risk averse and more tolerant of the apparent erosion of creditor rights represented by such things as the market's adoption of 'collective action' clauses and recent developments in the interpretation of the FSIA by US courts. It would be a mistake automatically to assume that either the current economic and market environment, or the investor or debtor behavior that it encourages, will remain constant. Perhaps with the passing of time, and changes in the current economic and market climate, EM investors may become more discriminating and inclined to impose more in the way of market discipline on debtors, and debtors may be subject to different influences as they form and implement their economic and financial plans and, if need be, their restructuring strategies.

Similarly, changing circumstances may result in changing current judgments about how well the international financial architecture works or how it should be changed.

(10) Creditor reactions to a debt restructuring are strongly influenced by how effectively the debtor engages with its creditors. In this sense, process matters, though how *much* it matters may vary depending upon prevailing economic and market circumstances. One way to make the restructuring process more orderly is to find mechanisms that encourage such engagement to be as constructive as possible.

Subsequent EMTA panel presentations in this series are expected to examine such issues as Whether Enfoceability of Bonds Matters?, Can the Restructuring Process Be Improved and, If So, How? and further consideration of the Appropriate Role of the Official Sector. General topics that will undoubtedly come up in these presentations are the role that market discipline can or should play, as well as the appropriate official sector role, in preventing or resolving sovereign financial crises in the Emerging Markets, as well as the implications of market discipline on the restructuring process. Private sector initiatives such as the IIF Principles will also be reviewed, in an effort to determine whether or not they are likely to be effective in improving the restructuring process.

Obviously, it is premature to predict what observations will be made, or what conclusions drawn, in these future presentations, but the current differences in views among rating agencies and investors noted in (1) and (4) above regarding the relative importance of capacity to pay (as a result of a restructuring's outcome) as opposed to willingness to do so (as reflected in the process followed by a country throughout its default and restructuring, and the perceptions resulting from that process), considered in light of changing economic and market conditions, do suggest some useful ways of looking at the efficacy of the current restructuring process and how it might be improved.

Because country debt restructurings must be approached on a case-by-case basis, their modalities and (certainly) their outcomes cannot be standardized. This almost inherent lack of uniformity is inevitable and may result in a somewhat ad hoc process that may sometimes seem unpredictable and sometimes seem (and perhaps be) disorderly.

Can this ad hoc process be made more orderly or more predictable? If so, the starting point in determining how is in recognizing that even countries in financial crisis nevertheless retain considerable power (they are sovereign after all) to determine how that crisis will be resolved. Because of the limited remedies available, and the tendency of courts to proceed cautiously, even legal actions that may be brought by some creditors against the debtor country seem likely to prove more of a nuisance than a serious disruption.

Whether or not a country's policies and actions can effectively prevent an economic or financial crisis from occurring, the timing and the modality of a restructuring are in many respects within the debtor country's control. While a debtor country may not, under the existing architecture, be able to control creditor reactions to its financial crisis and restructuring proposals, such reactions can generally be anticipated and influenced by the debtor country's conduct. This influence over creditor reactions is in part exerted through the debtor country's engagement with its creditors. By 'engagement', I mean the process undertaken by the debtor and how the debtor involves creditors in that process.

If there is a 'hole' in the existing international financial architecture, it is that how (or in some cases, whether!) a debtor country chooses to engage with its creditors is now too uncertain, and that uncertainty has the potential for resulting in an unconstructive engagement or, even worse, a perceived lack of it, as was the case in Argentina.

Rating agency and investor reaction to a debtor country that has recently restructured its debt and emerged from financial distress will in part depend on the country's track record of engagement with its creditors during the restructuring process. How important as a factor this track record will actually be, and what effect this may have on the debtor's access to foreign investor capital, including its cost, may depend on various exogenous factors such as general levels of liquidity and risk appetite. In more favorable economic and market conditions, when liquidity and tolerance for risk are high, this track record may be less important than the improvement in debt service capacity that in part resulted from the restructuring outcome.

In less favorable economic and market circumstances, however, particularly those characterized by less liquidity and greater risk discrimination, factors consistent with greater willingness to pay, such as how well the debtor was perceived as engaging with its creditors, may be given greater weight by rating agencies and investors.

If there is an opportunity to make the restructuring process more orderly, and possibly under some economic conditions to improve the debtor country's access to the international capital markets, it is to develop mechanisms to encourage that this engagement of debtors with their creditors during the restructuring process is as constructive as possible. In the interest of being as market-oriented as possible, any such mechanisms should be in the form of incentives rather than prescriptions. Such mechanisms may include IMF lending or other official sector policies or new contractual arrangements between debtors and their creditors. IMF lending policies are certainly not above review, and the effort to implement collective action clauses fell far short of ensuring that debtor engagement with creditors would be as constructive as possible.