

Global Consequences from Argentina and NML Capital: Improving Debt Restructuring and Achieving Global Bankruptcy

By Eric LeCompte

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Panel: *Argentina: of vultures and kings – the politics and economics of sovereign debt*

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It's a great honor to be with you and this group of esteemed experts on the panel today. Thanks to the International Bar Association for hosting this important panel and a special thanks to Chester Salomon and Tomas Araya for moderating and organizing today's conversation.

Before jumping into the topic, let me share with you who my organization is and why Jubilee USA (www.jubileeusa.org) became involved in what was seen – just a few years ago - as an obscure legal case, a case between a country that caucuses with the G20 and a group of hedge funds. Why Jubilee USA, founded by groups like American Jewish World Service, the US Conference of Catholic Bishops, most of the big 10 mainline national churches, unions and others, would ultimately file last year with the Supreme Court urging the high court to take the Argentina NML Case last year.

For Jubilee USA, our involvement is defined by our history and our mission.

First, our mission: to end extreme poverty and address inequality. Around the world, 85 people own more wealth than 3.5 billion people – more wealth than half of the world's population. The International Monetary Fund (IMF) notes the root cause of inequality is global sovereign debt – the basis of our credit based global financial system. 1 out of 5 people live in extreme poverty, and we believe that's 1 out of 5 people too many.

We know that extreme poverty exists because of a failure of debt, tax and trade policies. Right now, for every 10 dollars in aid from the developed world to the developing world, 50 dollars is leaving in debt payments, and another 100 dollars is leaving because of corruption, tax evasion and corporate tax avoidance. For every 10 dollars in aid, developing countries are losing 150 dollars in revenue, and these countries continue to take out new loans and rack up unsustainable debts. We represent the voice of our national member organizations and 400 faith

communities around the United States to change the policies that trap people in extreme poverty.

Our mission compels us to look at how the legal precedent in the Argentina NML case will affect some of the poorest economies in the world. We continue to move and encourage the G20, United Nations, US Government and the International Monetary Fund to change the policies that keep people poor. In fact, over the last year through our partnership with the White House, we won a commitment from the US government, the G20 and the IMF to secure 100 million dollars in debt relief for the three impoverished Ebola-stricken countries of Sierra Leone, Guinea and Liberia. Guinea spends more on debt than on public health and these monies will become a long-term investment in infrastructure. This February the International Monetary Fund institutionalized that commitment and we proudly support the work of the IMF as it extended this new debt relief facility to assist 38 of the world's least developed countries when they experience epidemics or disasters. We believe that this new debt relief and granting facility will likely help Nepal.

These continuous gains from our mission, define our history.

Jubilee USA's history counts over 130 billion dollars in debt relief. By international laws that we've won, proceeds from debt relief must build social infrastructure in the developing countries that benefit from debt relief. These policies include the Heavily Indebted Poor Countries Initiative (HIPC) and the Multilateral Debt Relief Initiative (MDRI). The last initiative was implemented by President George W. Bush. Bush's debt relief initiative, along with the funding his Administration organized to deal with the global AIDS crisis, is seen as among the most important aspects of his legacy. Congressional Quarterly cites Jubilee USA's efforts as the last bipartisan efforts on Capitol Hill because our organizing moves Republican and Democrats to work together. These bipartisan policies created more accountability and transparency in the financial system and more protections for poor countries. Much of the historical debt relief we won addresses debts that propped up some of the world's worst dictators or debts rooted in corruption.

So, as we won billions in debt relief and social investment for the countries that need it most, we were devastated to see that a small number of hedge funds, popularly known as "vulture funds" were targeting and actually collecting the aid monies we were winning for the poorest countries in the world.

In 2008, a vulture fund known as Donegal and Associates collected millions in debt relief money that Zambia had qualified for to build schools. They were targeting and collecting the very monies we were winning to help the poorest people in the world. As an aside, these predatory hedge funds were collecting debt relief aid monies funded by US tax payer dollars and then the predatory firms avoided paying US taxes themselves by being domiciled in tax havens.

Jubilee USA was compelled to be involved in this case because these so called “vulture funds” were targeting the aid monies we won for the world’s poorest economies.

They were targeting our very history.

Further, our coalition’s mission to protect the poor became front and center in this particular court case because the case’s precedent could exploit poor countries, making it more difficult for them to restructure debts and lead to defaults.

This brings us to the question: what is a “vulture fund” or predatory hedge fund? What happened to Argentina and why does the case precedent matter?

A “vulture fund” is a type of hedge fund that buys debt for pennies on the dollar of a poor country or an economy in financial distress, as in the case of Argentina after its 2001 default. The hedge fund then uses the laws of the financial jurisdiction where the debt contracts were signed to force full payment. These types of funds often make an upwards of a 1400 percent profit and refuse to participate in debt restructuring. The business practice originally developed from these funds buying up distressed companies and then selling off pieces for profits. The name comes from some of these companies naming their own business practice as scavengers.

However, the current practice developed into a more “predatory” taking advantage of economies facing distress or targeting and collecting aid monies the poorest countries in the world receive.

In Argentina’s case, after their 2001 default, they restructured their debt and settled with more than 92 percent of the groups and individuals who held Argentine debt in deals in 2005 and 2010. Two “vulture funds” who had bought the debt cheaply became “hold outs” and refused to participate in the debt restructuring. These funds litigated Argentina for full payment in New York Courts because the contracts were signed under New York law.

These predatory hedge funds refused to take the deals offered in 2005, 2010 and after. If they had, these hedge funds would have made a profit 157 times their initial purchase – but they seek to make a profit of more than 1200 times and set a precedent that forces the poorest countries in the world into submission. The precedent could prevent these countries from restructuring their debt and dealing with inequality.

That's where this case has a global impact.

Because much of the world's sovereign debt is contracted in the world's chief financial jurisdiction, New York State, any court decision within this system could set a powerful precedent in favor of a small group of predatory funds and against the world's poorest economies. Only a country with the resources of Argentina or a G20 country would have the wherewithal to spend an estimated 400 million dollars litigating this case over the last decade.

Countries like Grenada or the Democratic Republic of Congo, who we've determined could be impacted by this case precedent, don't have these resources (let alone the budget) to resist the predators. Now "vulture funds" have a powerful precedent in their tool box that could make it even more difficult for the world's poorest economies to oppose their will.

Part of the problem in this case is that the ruling out of New York interprets a parity, or a *pari passu* clause, in favor of the predators and against how every country, most financial institutions and the majority of investors interpret the clause. The court's opinion is opposed by the International Monetary Fund, the US government and the United Nations General Assembly.

Because Argentina is paying more than 92 percent of its bondholders at a restructured rate, the New York Court interpreted this to mean that the predatory funds and the hold-outs (those refusing to participate in the settlement) should also be paid – but instead of being paid the same restructured rate, as the US Government argued and as most of the world believes Argentina should pay – the court decided these funds should be paid in full.

The US 2nd Circuit Court ruling hurt poor economies and essentially ruled that there is no risk in extremely risky speculative behavior. Let me repeat that – the ruling says to these predatory actors, "Your high risk cheap debt buying is a guaranteed investment."

As a result, these types of hedge funds are quickly buying up debt across Eastern Europe, Africa and Caribbean and in the poorest countries of the world.

The precedent encourages all investors to “hold-out” during any country’s debt restructuring because the ruling offers a guarantee to be paid in full. After the 2nd Circuit Court ruling was made, the final appeal on this case was set in motion and Jubilee USA filed to the Supreme Court and urged them to take the case this past spring. We organized 80 religious and relief groups to sign onto our filing.

Our filing was joined by additional filings from banks, investors and numerous countries who sided with us, noting that this case could change global debt restructuring and impact the poorest countries on the world. During this legal battle the US government, majority investor groups and the International Monetary Fund weighed in on the side of Argentina because of the global repercussions of the case.

In spite of the global consensus, the Supreme Court refused to hear the case and, while hearing a related case, ultimately upheld the lower court’s ruling.

What does this court precedent mean for poor countries? It means trouble restructuring their debts and the targeting of their aid monies.

Jubilee USA determined that two other countries in the New York system could be affected initially.

- 1.) The Caribbean Island of Grenada, where a copycat case was in effect around the interpretation of parity or the *pari passu* clause. According to the most recent US Central Intelligence Agency statistics, nearly 40 percent of the population lives in poverty. A hold-out, the Taiwan Export Import Bank, is demanding full payment. The case was settled this year out of court and the Taiwan Export Import Bank settled as most of Argentina’s private creditors did at 50% haircut. The settlement is pretty good for Grenada but does nothing to challenge the court precedent.
- 2.) The Democratic Republic of Congo, which the United Nations ranks 2nd to last in Global development. The DRC lost a case to two “vulture funds” that now in the course of appeals will face the “parity” clauses. This is a judgment that goes back to the corrupt Mobutu regime when the country was still called Zaire. On 18 million dollars in principle, the so called “vulture funds” were awarded 68 million dollars.

At this point, the United Nations, world governments, investor associations, big banks and the International Monetary Fund all agree with Jubilee that predatory and hold-out behavior must be stopped.

There is clear global consensus to stop the behavior and mutual support of several solutions – but there is division about how far we should go.

The following solutions are proposed and in various stages of action:

- 1.) Contracts/Market Changes – After the crisis in Greece, US Treasury convened one of the largest groups of investors and banks, the International Capital Markets Association, to discuss contract changes that would ensure the parity clause would force hold-outs and “vulture funds” to participate when countries restructure their debts. Over the last year, Mexico, Kazakhstan and Vietnam have added these to new bond contracts. The International Monetary Fund and the G20 generally support similar proposals. These proposals, while important and supported by Jubilee USA, are not comprehensive enough to deal with the various types of debts that can be bought beyond sovereign bonds. Further, the contract clauses don’t deal with 900 billion in existing debt stock governed under New York law. This leads us to the need for statutory or law changes to the laws that govern the various financial jurisdictions.

- 2.) Statutory/Law Changes in Financial Jurisdictions – In the IMF’s October 2014 paper where they demonstrated support for changes in bond clauses, they also noted that if the precedent in this case impacts other countries, there should be changes to New York law. In particular, the IMF noted that changes to the Foreign Sovereign Immunities Act could prevent this type of behavior. Jubilee USA has previously introduced bipartisan legislation in the US Congress that would make the behavior less profitable. There’s also laws that could be introduced that would force hold-outs to sit at the table. Laws that deter predatory hedge funds have been passed in several financial jurisdictions in Europe like the United Kingdom and Belgium. We believe that every country in the world – whether they are a primary financial jurisdiction or not, should pass these kinds of laws. In addition to these statutory changes, there also needs to be shifts to the global financial system. This brings us to the final solution which also enjoys significant global support.

3.) Bankruptcy Process for Countries – In September of 2014 we won a vote at the UN General Assembly to begin a process to create a legal framework for bankruptcy for countries. Only 11 countries voted against this resolution and this year the General Assembly has held two framing sessions to prepare a global proposal. A bankruptcy process, similar to US Chapter 11 could force all debt holders to sit at the table during a debt restructuring. However, we need to understand that the global support for this process is derived from more than just wanting to stop the vulture funds. What the overwhelming support of the process shows, especially from poor countries and what are considered to be “middle income” countries, is that there is concern over the entire financial system. A global bankruptcy process, similar to what Adam Smith, the father of modern economics argued for, could do much more than stop predatory behavior. The process could prevent countries from defaulting in the first place and limit regional and global financial crisis. Yes, this process is important for preventing the next global financial crisis and increasing stability and predictability in the market. A bankruptcy road map from the UN Conference on Trade and Development (UNCTAD) was released to guide this process just a few weeks ago. I participated in this work which raises domestic bankruptcy procedures to a global level. The International Monetary Fund, through a series of papers over the last year and a half, explored aspects of global bankruptcy. Not as expansive as the work of the United Nations, but just as important, is the road map released in April of 2013 from the International Monetary Fund. Currently, the Executive Directors of the International Monetary Fund are pursuing this road map under the mantra that global debt restructuring is often, “too little and too late.”

It’s exciting that there is consensus to stop the predatory behavior and incredibly exciting that consensus is growing to actually change how the financial system operates to limit default and prevent global and regional financial crisis.

In closing my comments on the global consequences of Argentina vs NML Capital, I’d like to share a selection of Jubilee USA’s Supreme Court filing that is available along with other legal documents on the case on our website.

http://jubileeusa.org/fileadmin/13-990_-991_Amici_Brief_filed_3-24-14.pdf

Quotes from Jubilee USA’s Amicus Brief:

"The opinion...now threatens to unravel United States debt relief policy and undo much of the progress made on behalf of the poor."

"The presence of even a single holdout can deter otherwise cooperative creditors from agreeing to restructure a country's debt...the...decision below would make holding out and suing...the most rational strategy for creditors."

"Allowing the decision below to stand would...equip financial companies that prey on the poorest nations and people of the world with a game-changing legal precedent to accelerate their predation."

"If allowed to stand, the decision in this case...has the potential to generate systemic risks in the international system."

"Upholding the decision...would harm or frustrate numerous established policies of the United States...[that] began during the Bush administration and have been continued by the Obama administration."

"It is now accepted that it is more efficient and equitable to distribute debtor's assets among all the creditors than to give one creditor total satisfaction and make the rest go away emptyhanded. Bankruptcy thus serves the collective interests of creditors while at the same time preserving, to the extent possible, the viability of the debtor firm."

AND

"Using law to dispossess the poor for the pleasure of the powerful offends not only the sense of justice embodied in United States policy, but the even more ancient principles of biblical justice revealed in the scriptures of our faiths."

Thanks again for inviting me to participate in this crucial and vital discussion.

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