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**Insolvency Law: treatment of financial contracts and  
netting; sovereign debt restructuring**

**Note by the Secretariat**

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## **I. Insolvency treatment of financial contracts and netting**

1. At its forty-seventh session (2014), the Commission considered the outcomes of the colloquium on insolvency law held from 16 to 18 December 2013, in part, to consider possible topics for future work, including the insolvency treatment of financial contracts and netting (A/CN.9/803, para. 39(c)). It was reported that the development of the UNIDROIT Principles on Close-out Netting had led to there being some inconsistency with recommendations 101 to 107 of the UNCITRAL Legislative Guide on Insolvency Law and some concern was raised that the Legislative Guide no longer reflected best practice.

2. The Commission decided that, as Working Group V already had a rather full agenda, certain matters, including financial contracts, did not require immediate consideration. Nevertheless, the Secretariat was requested to monitor developments at other international organizations.<sup>1</sup>

3. The Commission will recall that the recommendations of the Legislative Guide on Insolvency Law, together with the World Bank's Principles for Effective Creditor Rights and Insolvency Systems, form the unified Standard on Creditor Rights and Insolvency — one of twelve areas identified as being useful for the operational work of the World Bank and the International Monetary Fund. Assessments of a country's institutional practices are undertaken against these standards and reports prepared,<sup>2</sup> which include recommendations for improvement if necessary.

4. Recommendations 101-107 and Principle 10.4 form the assessment standard for financial contracts. That standard was drafted prior to the financial crisis of 2008. A number of international instruments that take into account the lessons of that crisis have since been promulgated, including the Financial Stability Board's Key Attributes on Bank Resolution Regimes, the UNIDROIT Principles on Close-out Netting and amendments to the EC Financial Collateral Arrangements Directive.<sup>3</sup> The World Bank is currently working on revising Principle 10.4 to reflect those developments. Adoption of a revised Principle will mean that the two component elements of the unified standard will no longer be consistent. This could result in uncertainty for States using the Legislative Guide as a tool for insolvency law reform since there will be inconsistency as to best practice on the insolvency treatment of financial contracts.

5. The Commission may wish to reconsider its decision to postpone consideration of a possible revision of the relevant recommendations of the Legislative Guide and, notwithstanding that the current agenda of Working Group V remains rather full, whether an informal study might be undertaken to ascertain the amount of work required to review recommendations 101-107 of the Legislative Guide and ensure consistency with current international best practice. If only

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<sup>1</sup> *Official Records of the General Assembly, Sixty-ninth Session, Supplement No. 17 (A/69/17)*, para. 157.

<sup>2</sup> Reports on the Observance of Standards and Codes (ROSC).

<sup>3</sup> DIRECTIVE 2009/44/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims.

minor revisions were required, a draft might be prepared and submitted to Working Group V for consideration at its forty-ninth or fiftieth session in 2016. If more work was required, a report might be submitted to the Commission for consideration at its forty-ninth session in 2016. That study might take into account the need to coordinate with relevant international organizations.

## II. Sovereign debt restructuring

6. The Commission may wish to note the following recent developments with respect to the treatment of sovereign insolvency and the development of a multilateral framework for sovereign debt restructuring.

7. In paragraph 1 of its resolution 69/247, the General Assembly decided to establish an ad hoc committee, open to participation of all Member States and observers of the United Nations, to elaborate, through a process of intergovernmental negotiations and as a matter of priority during its sixty-ninth session, a multilateral legal framework for sovereign debt restructuring processes. The purpose of the framework would be to increase the efficiency, stability and predictability of the international financial system and achieve sustained, inclusive and equitable economic growth and sustainable development in accordance with national circumstances and priorities.

8. UNCTAD's Debt and Development Finance Branch (DDFB), the office responsible for handling debt issues, serves as the secretariat for the ad hoc committee. The first working session was held from 3-5 February 2015 in New York, with two additional three-day sessions mandated to be held from 28-30 April 2015 and in June or July 2015.

9. UNCITRAL's work and expertise in the areas of insolvency, particularly cross-border insolvency, and dispute resolution were mentioned by various participants at the first working session of the ad hoc committee as relevant to possible work to be undertaken in the area of sovereign debt. No conclusions were drawn from the first working session,<sup>4</sup> but the Bureau was to produce a workplan, with one of its objectives being to draft a paper describing the different options available with regard to a multilateral legal framework for sovereign debt restructuring processes.

10. UNCTAD's work on the ad hoc committee is supplemented by other activities including:

(a) A meeting with the Initiative for Policy Dialogue (IPD) at Columbia University was held at the end of March 2015 to provide further assistance to the Bureau's work in drafting the paper describing the different options available for creating a multilateral framework on sovereign debt restructuring processes and to discuss a Debt Workout Roadmap document.<sup>5</sup> Mention was made of UNCITRAL in

<sup>4</sup> A draft summary of the working group session is available at: [www.unctad.info/upload/Debt%20Portal/GA%20Ad%20hoc%20committee%20statements/Summary-Ad%20hoc%20Committee%20First%20working%20session%20Feb.%202015.pdf](http://www.unctad.info/upload/Debt%20Portal/GA%20Ad%20hoc%20committee%20statements/Summary-Ad%20hoc%20Committee%20First%20working%20session%20Feb.%202015.pdf).

<sup>5</sup> A summary of the meeting is available at: [www.unctad.info/upload/Debt%20Portal/2015\\_03\\_31\\_IPD\\_UNCTAD\\_Columbia\\_Summary.pdf](http://www.unctad.info/upload/Debt%20Portal/2015_03_31_IPD_UNCTAD_Columbia_Summary.pdf).

the context of possibly developing a model for domestic law applicable to sovereign debt restructuring, including model provisions on issues concerning creditors who provide new financing to maintain liquidity during the work, or developing principles of sovereign debt contracts to determine what good collective action clauses (CAC) are, to redefine the notion of default and to incorporate provision for a stay or moratorium on creditor action;

(b) A project called “Promoting Responsible Sovereign Financing” was launched in 2009, which seeks to forge an international consensus in this area. The project has two parts: (i) developing internationally accepted “Principles for Responsible Sovereign Lending and Borrowing” (PRSLB);<sup>6</sup> and (ii) forming international consensus around a procedure for a “Debt Workout Mechanism” (DWM).<sup>7</sup>

11. In late April 2015, UNCTAD published a paper entitled “Sovereign Debt Workouts: Going Forward — Roadmap and Guide”.<sup>8</sup> The Roadmap contains six sections: (a) a concise summary of the shortcomings of current practice with respect to sovereign debt workouts; (b) a set of five principles for sovereign debt workouts — legitimacy, impartiality, transparency, good faith and sustainability (UNCTAD’s Sovereign Debt Workout Principles); (c) steps to be taken by debtor states prior to debt workouts; (d) recommendations for a reformed debt workout process; and (e) recommendations for courts deciding sovereign debt cases. The accompanying Guide for Sovereign Debt Workouts is intended to “reflect the extent to which sovereign debt workouts actually integrate, or should integrate, a set of principles and rules promoting a coherent, legitimate framework for efficient and effective sustainable debt workouts that are able to restore debt sustainability.”<sup>9</sup> It discusses in some detail the various workout stages and implementation of the principles and recommendations by stakeholders and institutions involved in debt restructuring, including possible institutional reform and an option to establish a Sovereign Debt Workout Institution (SDWI) to better implement the restructuring steps. The document was to be discussed during the second working session of the ad hoc committee.<sup>10</sup>

12. Mention is made in the Guide of the possibility of supporting sovereign workouts with mediation and formal arbitration processes, governed by internationally accepted standards (which may require some modification), through

<sup>6</sup> A high-level conference was co-hosted with the Ministry of Finance and Ministry of Commerce of China (8 September 2010) as part of UNCTAD’s 2010 World Investment Forum and two expert group meetings were held in November 2009 (Geneva) and March 2010 (Tunis). A consolidated version of the Principles on Responsible Sovereign Financing was released on 21 January 2012, available at [www.unctad.info/en/Debt-Portal](http://www.unctad.info/en/Debt-Portal).

<sup>7</sup> The mechanism is being designed by a Working Group coordinated by UNCTAD Secretariat. It does not “offer any pre-elaborated proposal or solution for debt workout mechanism but will provide the platform and intellectual inputs to engage in a collective, equitable, inclusive and transparent discussion to propose and elaborate a [DWM]”. Five meetings were held between July 2013 and February 2015 to identify the building blocks of a DWM and discuss the various options for its design.

<sup>8</sup> Available at: [http://unctad.org/en/PublicationsLibrary/gdsddf2015misc1\\_en.pdf](http://unctad.org/en/PublicationsLibrary/gdsddf2015misc1_en.pdf).

<sup>9</sup> UNCTAD Guide for Sovereign Debt Workouts, p. 15.

<sup>10</sup> No summary of the second ad hoc meeting was available as at the date of submission of this document.

an institution agreed upon by the parties or a tribunal hosted by the SDWI. The issue of how arbitration awards would bind States and creditors is also mentioned, based on the legal basis of the SDWI (e.g. treaty-based, subsidiary body of the United Nations or independent institution established as a non-profit organization governed by private law).

13. The Commission may wish to request the Secretariat to monitor developments in international work relating to the elaboration of a sovereign debt restructuring mechanism, including the work of the ad hoc committee, with a view to reporting back to the Commission at its forty-ninth session on those developments and their implications for the work of the Commission in areas of current interest or for possible future work.

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