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# How could a new universal code of conduct prevent and resolve sovereign debt crises? Proposals for design and implementation

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## Abstract

In response to the COVID-19 crisis, government spending around the world has increased significantly and will continue to grow as interest rates rise. In view of protracted and costly sovereign debt restructurings in the previous decades, contractual and noncontractual instruments of the Global Debt Governance-system have been insufficient to prevent and to resolve sovereign debt crisis. While statutory and comprehensive approaches to resolve sovereign debt crises lack the political support such as an insolvency procedure for states incomprehensive contractual approaches including collective action clauses (CACs) cannot fully secure a comprehensive debt resolution. Codes of conduct could constitute an essential instrument to contribute to preventing and resolving sovereign debt crises. There are two main impediments for establishing and adopting such codes of conduct effectively. First, a range of codes of conduct with different institutional settings and principles have been established – and partly implemented – including those of the Institute of International Finance, the United Nations, the G20, the IMF and the OECD. However, differing institutional

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settings do not contribute to preventing or effectively resolving debt crises when the actors concerned apply different codes of conduct. We suggest a new universal code of conduct in which the elements of the various proposals made by the public and private sectors would be combined. Second, the global economic governance structure lacks incentives for creditors and debtors to adhere to this new universal code of conduct. This paper proposes measures providing incentives for creditors and debtors to apply the nonstatutory code of conduct.

#### KEYWORDS

code of conduct, collective action clauses, COVID-19, debt crisis, debt, sovereign debt

## 1 | INTRODUCTION

While the debt levels in all types of countries were already high prior to the COVID-19 crisis a large number of countries have been in debt distress in the aftermath of the COVID-19 crisis (IMF, 2020a). In responding to the COVID-19 crisis, government expenditures have significantly risen. Between 2019 and 2021 gross government debt in percent of gross domestic product (GDP) is projected to increase in advanced countries from about 104% in 2019 to nearly 122% in 2021, in Emerging Market and middle-income countries (MICs) from 54.7% in 2019 to 64.3% in 2021 and in low-income countries (LICs) from 44.2% to 50.2% (IMF, 2021). While these debt levels seem to be significantly lower in LICs it has to be taken into account that LICs are particularly affected because they have not been able to mobilize needed financial resources on their own. The International Monetary Fund (IMF) and the World Bank (WB) have considered more than half of the world's LICs to be highly indebted, that is, to be at high risk of debt or are in debt distress (IMF, 2022).

In order to prevent a further deterioration of the debt situation in many countries and to adequately deal with existing debt crises as well as in view of protracted and costly sovereign debt restructurings in the previous decades<sup>1</sup>, the current global debt governance system needs be reformed. This system comprises policy tools to avoid and resolve debt crises. Although it is difficult to make a binary differentiation between instruments for averting and those for resolving debt crises because some instruments address both prevention and resolution this distinction represents a crucial prerequisite for adopting various instruments at various stages of indebtedness (Berensmann, 2017).

For preventing debt crises, the current global debt governance system consists of policy instruments that aim to promote prudent lending and borrowing such as (voluntary) codes of conduct that lay down general principles applicable to all market participants before a debt crisis transparency. Further tools to prevent debt crises include public debt management as well as the debt monitoring and assessment frameworks established by IFIs such as the Debt Sustainability Framework (DSF), the International Development Association's (IDA's) Sustainable

Development Finance Policy and the IMF's Debt Limit Policy. Local-currency bond markets, especially local government bond markets, could also help to reduce external debt vulnerability. The recently implemented Debt Service Suspension Initiative (DSSI) has aimed to solve acute liquidity problems in developing countries in the aftermath of the COVID-19 crisis.

Instruments for resolving debt crises should be used when a country faces unsustainable debt. The current global debt governance system includes a number of policy tools to manage debt crises such as codes of conduct, the recently established Common Framework for debt treatment beyond the DSSI (Common Framework), Paris Club's and London Club's debt restructurings, collective action clauses (CACs) and debt swaps.

Since the existing instruments of the Global Debt Governance system cannot ensure effective, comprehensive, fair, and transparent sovereign debt crisis resolutions existing instruments need to be reformed and new instruments need to be established. One main new and yet missing instrument to resolve debt crises is an insolvency procedure for states<sup>2</sup> and main existing tools to be reformed are codes of conduct and CACs. As most actors in the international financial markets reject far-reaching statutory approaches for sovereign debt restructuring (such as an international insolvency procedure for states), both contractual approaches (such as CACs) and voluntary approaches (such as codes of conduct) constitute crucial instruments for restructuring sovereign debt.

A voluntary code of conduct could constitute an essential instrument to fill this gap and to complement other instruments of the Global Debt Governance system including CACs, recently established tools such as the Common Framework or a potential insolvency procedure for states. Appropriately designed codes of conduct can contribute to prevent and resolve sovereign debt crises. Codes of conduct consist of a set of mostly nonstatutory rules of conduct valid for all market participants, such as good faith negotiations, transparency of the debtor's financial position, and its agreements with other creditors or equitable treatment of all creditors that is valid for all market participants, both prior to and during a debt crisis.

This paper aims at contributing to the existing literature on codes of conduct by bringing together the main proposed and implemented codes of conduct used to avoid and resolve sovereign debt crises and by providing a new proposal that combines different elements from the existing codes of conduct. A specific emphasis is laid on finding a compromise between the differing views of the different parties involved in the debt restructuring process. This proposal contains two main elements: (i) the institutional setting and (ii) principles of a code of conduct.

Although some existing articles and books have analyzed individual codes of conduct or certain aspects/contentious issues in these codes of conduct, such as Berensmann (2011), Espósito et al. (2013), Gelpern (2013), Guzman and Stiglitz (2016), Li (2015), Li and Panizza (2013), and Ritter (2009), papers in which the main proposals are compared have not yet been written. Up to now, no paper has suggested a combined approach merging the different aspects of the various codes of conduct.

In assessing the potential contribution of a code of conduct to resolving sovereign debt crises, we examine its institutional setting and principles. Particular emphasis is laid on delineating the governance structure of a code of conduct.

Against this background, the main question that this paper poses is: How should a code of conduct be designed to prevent and ensure an effective, efficient, comprehensive, fair, and transparent sovereign debt crisis resolution? To answer this question, Section 2 outlines the deficiencies in the current Global Debt Governance system. Section 3 gives an overview of the different proposals for a code of conduct. The fourth section assesses how codes of conduct can address these deficiencies. This analysis forms the basis of proposals for the design of an appropriate code of

conduct provided in the final section, including the main features of a universal code of conduct and implementation proposals along with policy recommendations addressed both to creditors and debtors.

## 2 | DEFICIENCIES OF THE GLOBAL DEBT GOVERNANCE SYSTEM

The main deficiencies of the Global Debt Governance system used to avoid and resolve sovereign debt crises currently include (i) collective action problems, (ii) ineffective instruments, (iii) information asymmetry/nontransparent information, (iv) lack of comprehensive instruments/lack of legitimacy/fragmentation of the Global Debt Governance system (Berensmann, 2017). These weaknesses mean that sovereign debt crises are not prevented and bring about delayed, disorderly, and costly sovereign debt restructurings (IMF, 2013).

### 2.1 | Collective action problems

In the past decade, the sovereign debt creditor group of the developing countries has become more diversified because sovereign bond issues have increased, relative to official multilateral and bilateral debt volumes. Since sovereign bonds are held by heterogeneous groups of creditors, coordination, and collective action problems exacerbate the timely and efficient resolution of debt crises. These collective action problems comprise the “rush-to-the-exit problem,” the “holdout problem,” and the “rush-to-the-courthouse problem.” The “rush-to-the-exit problem” describes a situation in which creditors seek to sell their bonds because they are concerned about the debtor defaulting. “Holdout” behavior of creditors takes place when a minority of creditors block the debt restructuring decisions of the majority of creditors. The reason behind this holdout behavior is that these creditors intend to enforce their full claims after the restructuring process has been completed. The “rush-to-the-courthouse problem” occurs when creditors legally enforce their claims prior to a debt crisis (Roubini, 2002, pp. 322–323).

According to the IMF, enhanced CACs allowing voting procedures across all bond issuances have contributed to solve collective action problems and to conduct more effective debt resolutions. However, collective action problems still remain. Challenges to secure creditors’ participation in debt restructurings and their adherence to debt restructuring decisions remain (IMF, 2020c, pp. 29–30).

#### **Box 1: Country examples for heterogeneous creditor groups during debt exchanges**

During the Argentinean debt restructuring in the 2000s, for example, there was a diverse creditor group with different interests and different bonds – with and without enhanced CACs. During the most recent debt restructuring, three separate creditor committees were founded, covering 40%–45% of the eligible bonds. One large bondholder negotiated on his own with the Argentinean government, and other bondholders did not join any creditor committees. Since the creditor committees held diverse views on debt restructuring conditions, creditor coordination was rather difficult.

In the previous Ecuadorian debt restructuring of 2020, there was also a diverse creditor base. Although three creditor committees were founded, the government attained high levels of creditor participation in the debt restructuring because the government conducted transparent negotiations with creditors (IMF, 2020c, pp. 20–21).

## 2.2 | Ineffective instruments

Some instruments of the Global Debt Governance system are ineffective because they are noncontractual, and therefore nonbinding such as codes of conduct or debt fora. In so far, these instruments represent soft modes of governance. However, monitoring systems of these instruments contribute to their effectiveness. Several measures are available to increase the binding character of codes of conduct, such as those good governance structures put in place by the IIF code of conduct or the G20 Guidelines. The IIF Principles are subject to a monitoring by a Group of Trustees and the G20 Guidelines have been assessed by a diagnostic pool put in place by the IMF and the WB.

## 2.3 | Information asymmetry and intransparent information

Owing to information asymmetries, debt restructuring has often been delayed, unfair, intransparent, and inefficient. Debt workout processes have often been intransparent in various respects. Creditors often have had incomplete information on the debtors' debt data because debtors fail to disclose complete information on their debt situations. In addition, information asymmetry among stakeholders has existed (Gelpern, 2013, p. 347). There is a need for a common understanding about the volume of outstanding debt, rules for the treatment of claims, and the classification of claims. Intransparency on the payment terms and terms of treatment impedes creditors as well as other stakeholders' risk assessments, and it generates intercreditor equity concerns. Similarly, transparency about the debtor's economic situation is crucial to assess the debtor's repayment capacity (IMF, 2020c).

To address this problem in 2021, the OECD, together with the UK government and the IIF, have established a debt transparency initiative convening main creditors of LICs including multilateral institutions, central banks, finance ministries, civil society organizations, and commercial banks. The aim is to obtain more comprehensive and precise data on public debt so that informed decisions can be made. This initiative aims to gather, assess and report on the debt situation in LICs and it should be in line with the Voluntary Principles on Debt Transparency of the IIF. In this way nontransparent bilateral lending to LICs can be uncovered (IIF, 2019; OECD, 2021).

### **Box 2: Information asymmetry and intransparent information: The case of Mozambique's "hidden debt"**

A good example of information asymmetry and intransparent information is the case of Mozambique's "hidden debt" uncovered in 2016 in connection with loans from Credit Suisse and VTB Capital to two state-owned companies, Proindicus and MAM,

amounting to around USD 1.1 billion, as well as several smaller bilateral loans including the company EMATUM (USD 0.3 billion) with a total volume of USD 1.4 billion (about 11% of 2015 GDP). These three companies were established shortly before the loans were granted and a senior official of the security service was the managing director of these companies. As a result, Mozambique's debt sustainability rating deteriorated leading to a lengthy restructuring process. In addition, many donors temporarily stopped their budget support and the IMF program that was running at the time was suspended. In 2021, legal disputes with clients were still ongoing (AfDB, 2021, p. 78; IMF, 2018, p. 4).

## 2.4 | Lack of comprehensive instruments and fragmentation of the Global Debt Governance system

The current Global Debt Governance system lacks comprehensive instruments because it does not include a comprehensive debt workout mechanism that covers all classes of debt and all stakeholders. No comprehensive debt restructuring mechanisms exist because there are various creditors and creditor groups covering different types of debt and following different processes (UNCTAD, 2015, pp. 12–13). This lack of comprehensiveness is associated with a fragmentation of the Global Debt Governance system. Diverse types of debt have been treated in various fora, for example, the London Club deals with private debt, the Paris Club handles bilateral official debt, and IFIs treat official multilateral debt (Li, 2015, p. 332; UNCTAD, 2015, pp. 12–13 and 18). Although there has been cooperation among these different fora, comprehensive debt treatment is missing, even though recent examples of cooperation between some stakeholders are the joint decisions of the G20, the Paris Club, and the IFIs on the Debt Service Suspension Initiative (DSSI) and the Common Framework for Debt Treatments beyond the DSSI (Common Framework henceforth) (G20 & Paris Club, 2020a, 2020b). However, the debt composition in recent years included other important creditors, particularly private creditors who have partly been reluctant to provide debt service suspension<sup>3</sup> and/or participation on comparable terms in the debt treatments within the Common Framework. In addition, some existing tools can only be applied to specific types of debt, such as CACs.

The missing linkage of different types of tools belonging to the Global Debt Governance system contributes to a fragmented system. For example, only some of the codes of conduct have been linked to the debt monitoring and assessment tools of the international financial institutions (IFIs), such as the code of conduct proposed by the G20 that also addresses the tools of the IFIs' debt governance framework. In the same vein, the codes of conduct can complement CACs (Berensmann, 2017).

### Box 3: Examples for protracted, incomplete and non-transparent debt restructurings

Recent examples for protracted, incomplete and non-transparent debt restructurings were Mozambique, Republic of Congo, Chad, and Gambia. Mozambique achieved an agreement only for one type of debt, sovereign bond 3 years after the proposal was put forward. By contrast, loans continue to be under negotiation/litigation. The restructuring

procedure for the Republic of Congo that started in early 2018 was not completed at the end of 2020 because external debt with commercial commodity traders were not finished. In the case of Chad, two debt restructuring agreements in 2015 and in 2017 were needed because an inappropriate first restructuring agreement in 2015 increased the net present value of the loan by enforcing fees rather than lowering the net present value. In the case of The Gambia the debt restructuring process lasted 2 years for achieving an agreement. One main reason was that the procedure was complicated by the participation of some non-Paris Club creditors and plurilaterals that held a large volume of credits (IMF, 2019, p. 39).

The Argentinean debt crisis at the end of the 1990s showed that a timely debt restructuring is needed when debt dynamics have become unsustainable. In cases where debt restructuring has become inevitable, delaying debt restructuring increases the costs of the crisis and makes debt resolution more complicated. For this reason, a more orderly approach to debt restructuring is needed. This Argentinean debt crisis was one main reason the Fund started its work on the SDRM (IMF, 2003d). Similarly, the Argentinean case shows that complex debt structures with heterogeneous creditor groups cannot be solved with decentralized contractual frameworks such as CACs because this instrument cannot address collective action and creditor coordination problems (Hagan, 2005, p. 303).

### 3 | THE ROLE OF CODES OF CONDUCT IN THE GLOBAL DEBT GOVERNANCE SYSTEM

Since most actors in the international financial markets reject far-reaching statutory approaches for sovereign debt restructuring such as an international insolvency procedure for states, both contractual approaches such as CACs and voluntary approaches such as codes of conduct constitute crucial instruments for restructuring sovereign debt.

This part deals with an assessment of the role of, and need for, codes of conduct in the Global Debt Governance system, including its complementary role to other instruments, such as CACs, and potential statutory approaches. Since the focus of the paper is on developing a universal code of conduct, this section only assesses two additional instruments of the Global Debt Governance system in more detail. First, one comprehensive statutory proposal for an insolvency procedure for states is briefly analyzed. Second, the main contractual instruments – CACs – are assessed, and proposals to further strengthen the use of existing CACs are made. Other instruments to prevent and resolve sovereign debt crises are not dealt with in detail in this paper. These include IFIs' debt governance frameworks,<sup>4</sup> debt management tools, sovereign debt forums, debt swaps, debt moratoria, state-contingent bonds, antivulture fund legislation, the Common Framework, and former debt relief initiatives.<sup>5</sup>

#### 3.1 | Statutory approach: Insolvency procedure for states

In the aftermath of the Asian financial crisis in the early 2000s, several statutory approaches were put forward, including a sovereign debt restructuring mechanism (SDRM) proposed by the IMF. However, it is politically challenging to launch such an approach (Li, 2015, p. 330). In 2003, the



members of the IMF—including industrialized countries and emerging markets—voted against this approach (IMF, 2003a, 2003c, 2020c, p. 7).<sup>6</sup> In the same vein, private creditors rejected this approach because they feared that a selective coverage of debt under the SDRM could generate subordinated classes of debt, leading to rising funding costs to borrowers and possibly lower investment-grade ratings (EMCA et al., 2002).

On the one hand, an insolvency procedure for sovereign states represents a comprehensive approach because it covers all types of debt in cases where an insolvency procedure is entitled to restructure all types of debt. In the same vein, it contributes toward solving collective action problems because it coordinates diverse creditors holding various classes of debt prior to, and during, a debt crisis. Moreover, an insolvency procedure offers a predictable and transparent roadmap for debt restructuring, contributing to a timely and orderly restructuring (Helleiner, 2008). In this way, such a procedure contributes toward reducing restructuring costs by avoiding delays in initiating restructuring processes. Above all, it would contribute to equal treatment of debtor countries and creditors, given the respective designs (Berensmann, 2017).

On the other hand, establishing and implementing insolvency procedures for sovereign states is associated with a number of problems. First, it is quite demanding to implement an insolvency procedure effectively, given the difficulties in legally enforcing it (Li, 2015, p. 330). Second, debtor states might fear loss of reputation, thereby losing access to international financial markets as soon as such a procedure has been initiated. Third, creditors might be concerned that introducing an insolvency procedure could incentivize debtor countries to initiate it with the aim of facilitating debt restructuring and reducing the debt volume (debtor moral hazard) (Berensmann & Herzberg, 2009). Private creditors fear that such a procedure would facilitate sovereign debtors to be able to default (Bolton & Skeel, 2004, p. 765).

### 3.2 | Collective action clauses

To date, the international community has instead established contractual—foremost CACs—rather than statutory approaches for solving sovereign debt problems. CACs contribute to addressing collective action problems but they cannot solve these problems entirely. CACs are included in sovereign bonds in order to simplify sovereign bond restructuring. By 2014, the main types of classic CACs have been majority restructuring clauses, acceleration clauses, or representation clauses. Majority clauses, for instance, approve a qualified majority of bondholders to include minorities in contract modifications. In this way, agreed restructuring conditions are enforced and mitigate the risk that minorities will block it (Bardozzetti & Dottori, 2014; Ghosal & Thampanishvong, 2013; Häsel, 2009; IMF, 2014, 2003b; Picarelli et al., 2019; Schwarcz, 2015).

One weakness of these clauses was that they only partly dealt with collective action problems because majority votes have to be taken for each bond issuance (IMF, 2014). For this reason, in 2014, the International Capital Market Association (ICMA) established enhanced CACs that allow voting procedures across all bond issuances – single-limb CACs, which require only one single vote across all bonds with an aggregate threshold of 66% (ICMA, 2014). In this way, the holdout behavior of creditors is addressed because a supermajority of bondholders can vote to oblige holdout creditors to take part in the respective restructuring (IMF, 2014). Fang et al. (2021) have shown within simulations that single-limb CACs would reduce holdout and litigation risks substantially. By contrast, classic CACs cannot ensure high participation rates.

In addition, CACs have not been included in all sovereign bonds issued on international financial markets (IMF, 2014, 2020c). Although about 95% of international sovereign bonds comprise

diverse types of CACs, about half of the outstanding stock of international sovereign bonds do not include enhanced CACs (IMF, 2020c, p. 30). About 91% of new international bond issuances have incorporated the enhanced CACs (IMF, 2020c, p. 21). Recent studies have shown that bonds with enhanced CACs are traded at a lower yield in secondary markets (Carletti et al., 2021; Chung & Papaioannou, 2020; Picarelli et al., 2019).

Supplementary legal techniques have been applied to enhance creditor coordination and participation in bond conversions and to enhance the effectiveness of CACs. These include conditioning in the exchange offer in terms of attaining a minimum participation threshold after CACs have been initiated. The aim is to ensure that the debtor only continues with the exchange in cases where a qualified majority of creditors have agreed to take part in the exchange. The advantage for the creditor is that the bonds exchanged do not contain the risk that participating creditors will not hold bonds with a low value generated by low levels of participation. In Ecuador, for example, the exchange was conditional on a minimum participation threshold of 80% after the CACs had been activated (IMF, 2020c, p. 26).<sup>7</sup>

In addition, model clauses facilitate changing payment terms in loan contracts by a majority of creditors. For example, CACs can be used to provide less favorable financial terms to nonconsenting bondholders, including less favorable maturity structures or lower interest rates. The aim is to provide incentives for creditors to participate in the conversion of bonds. In the Ecuadorian and Argentinean cases, less favorable financial terms, such as less favorable maturity structures, were introduced for nonconsenting bondholders (IMF, 2020c, pp. 26–27).<sup>8</sup>

A further weakness of CACs has been that they are not a comprehensive approach to resolving sovereign debt crises in developing countries because they are only applied to one type of debt – bonds. By contrast, private debt and some types of public debt, such as subsovereign debt, bilateral official debt, and multilateral debt, do not include CACs. For broadening the use of enhanced CACs in types of debt other than international sovereign bonds, enhanced CACs should also be included in subsovereign foreign-law-governed bonds.<sup>9</sup>

On the whole, enhanced CACs and amendments to them that include conditioning in the exchange offer and introduction of trust structures could further strengthen CACs. Similarly, applying CACs to syndicated loans and subsovereign foreign-law-governed bonds broadens their use. In spite of these reform proposals, codes of conduct are complementary to CACs because codes of conduct represent comprehensive instruments that can be applied to all types of debt. In addition, codes of conduct can be linked to CACs—and even strengthen CACs—because they promote creditor coordination by facilitating creditor dialogue, enhance transparency on debt contracts, ensure a timely flow of information among the debtors and creditors, and contribute to negotiations in good faith.

### 3.3 | Codes of conduct

Codes of conduct can contribute to both crisis prevention and crisis resolution. Concerning crisis prevention, codes of conduct should avoid renewed debt problems and prevent a crisis from affecting other countries by enhancing transparency and ensuring a timely flow of information among the debtors and creditors. By the same token, a close debtor–creditor dialogue should contribute toward avoiding debt crises. Codes of conduct also support debt crisis resolution because they contribute toward simplifying restructuring procedures by increasing the predictability and transparency of the negotiation processes, and by strengthening cooperation between creditors and debtors. By applying the guidelines of those codes of conduct – including equal treatment

of creditors or enhanced transparency of the restructuring process – codes of conduct contribute toward preventing scenarios in which minorities do not take part in a restructuring procedure agreed by a majority of creditors (Berensmann, 2017). According to the IIF, the IIF-Principles promoted crisis prevention through enhanced data and policy transparency as well as clear communication and dialogue between debtors, creditors, and investors. One important tool is the investor relations programs. By the same token, the IIF Principles contribute to effective crisis resolution through good-faith negotiations with representative groups of creditors and by treating all creditors equally (IIF, 2020a, p. 6).

Codes of conduct are usually noncontractual – contractual—and therefore nonbinding – binding—soft modes of governance. One main objection to codes of conduct is that the absence of legal foundations could render them ineffective. However, there are several measures available to enhance the binding character of a code of conduct, such as a good governance structure including monitoring systems. One prime example in this respect is the code of conduct established by the IIF as a monitoring system constitutes one key element. Adherence to this code of conduct has frequently and systematically been reviewed.

On the one hand, the IIF code of conduct is voluntary, but on the other hand, the governance structure makes it binding for debtors and creditors. Accordingly, a binary separation between mandatory and soft modes of governance is unsuitable because the IIF code of conduct has shown that a soft mode of governance can shift to a harder mode of governance. By adhering to the IIF Principles, debtors show their willingness to contribute to transparent, fair, and effective debt restructuring, and thereby enhance their reputations. Moreover, a shift toward a harder mode of governance has taken place over time because this code of conduct has been applied more precisely with respect to the role of creditor committees. In 2007, best-practice principles for the way creditor committees should operate were introduced, providing guidance on the composition of members and the level of interaction during the restructuring processes (Berensmann, 2017; IIF, 2020a; Ritter, 2009).

A further example for establishing governance is the diagnostic tool for the G20 Guidelines put in place by the IMF and the WB. These institutions have developed and adopted a standardized diagnostic tool, including a number of practices for each of the five key dimensions named in the Guidelines. This tool gives G20 bilateral creditors and their agencies the opportunity to assess whether they meet the Guidelines (IMF and IDA, 2019).

Even though a code of conduct can reduce collective action problems, it cannot however fully remove them because it can neither formally protect against creditor litigation nor prevent a rush to the exit; nor does a code deliver any safeguards against holdout behaviors. The different principles of the codes of conduct such as good faith actions—that include the coordination of various debt instruments in creditor committees, equal treatment of creditors, and enhanced transparency—can contribute to solving collective action problems because these principles promote cooperation between creditors and debtors. Moreover, these principles enhance the creditors' faith in an orderly and fair debt restructuring processes. Accordingly, creditors may refrain from the rush-to-the-exit problem, the holdout problem, and the rush-to-the-courthouse problem (Berensmann, 2011; Roubini & Setser, 2003, pp. 9–10).

At the same time, codes of conduct can reduce the fragmentation of the Global Debt Governance system. It would be necessary to establish a unified code of conduct that can enhance the predictability of crisis management and increase confidence between debtors and creditors, as well as among creditors. What is more, the codes of conduct proposed must be linked to other instruments of the Global Debt Governance system, such as CACs, the *pari passu* clause, and

instruments of the IFIs, to monitor and assess debt sustainability as well as to the Paris or London Club agreements.

The principles relating to transparency and debtor-creditor dialogue can address the problem of information asymmetry. Codes of conduct would improve transparency during debt restructuring processes by providing timely information about the debtor's financial situation. These principles foster confidence between the creditors and the debtors as well as among creditors prior to and during a debt crisis.

In sum, codes of conduct are complementary to CACs because codes of conduct represent comprehensive instruments that can be applied to all types of debt. In addition, codes of conduct can be linked to CACs—and even strengthen CACs—because they promote creditor coordination by facilitating creditor dialogue, enhance transparency on debt contracts, ensure a timely flow of information among the debtors and creditors, and contribute to negotiations in good faith.

Although legal techniques are more effective incentives for creditors and debtors to adhere to codes of conduct should be introduced. In case market participants consider the use of, and adherence to, the new code of conduct as a means of increasing their reputations it is in a sovereign debtor's own interests to adhere to this code. For this reason, peer and market pressure is important through a number of measures: (i) the publication of a country list disclosing the countries adhering to the code of conduct (Banque de France, 2003, p. 14), (ii) encouraging rating agencies to take into account adherence to codes of conduct in their macroeconomic analyses (Ritter, 2009, p. 25), (iii) the inclusion of codes of conduct into sovereign bond contracts (Banque de France, 2003, p. 14), and (iv) the incorporation of codes of conduct in the lending policies of the IFIs, such as in the lending-into-arrears policy of the IMF (Banque de France, 2003, p. 14) or as performance criterion at the IMF.

#### 4 | COMPARISON OF THE MAIN PROPOSALS FOR A CODE OF CONDUCT

This section provides both an overview and an analysis of selected codes of conduct that have already been put forward. The main similarities and differences of the various codes of conduct will be elaborated: first with regard to their general institutional setting, including objectives, stakeholders addressed, contexts and institutional processes, scope of debt covered, governance structure, and integration into the international financial architecture; second with regard to the principles set out in these said codes of conduct. The different institutional settings and principles also reflect the divergent interests of the actors proposing and implementing them. Differing institutional settings and principles do not contribute to preventing or effectively managing and resolving sovereign debt crises when the actors concerned apply different codes of conduct. In response to the financial crises of the late 1990s and 2008, the private and public sectors put forward several codes of conduct. However, only four codes of conduct have been implemented: the IIF's "Principles for Stable Capital Flows and Fair Debt Restructuring," the LIA policy, to some extent the G20 guidelines and the OECD's "Principles and Guidelines on Sustainable Lending for Low Income Countries."

Together with various emerging economies, the world's most important association of private banks—the IIF—launched the voluntary "Principles for Stable Capital Flows and Fair Debt Restructuring" in 2005 with the aim of avoiding or managing debt crises.<sup>10</sup> One main reason for establishing these voluntary principles was to avoid implementing a coercive statutory approach in terms of the SDRM. The private sector did not want to be forced to take part in any debt

restructuring and therefore proposed an alternative voluntary approach. These principles encompass voluntary, market-based, and flexible guidelines for sovereign debtors and private creditors with the objective of promoting financial stability and sustainable growth as well as supporting and preserving stable private capital flows. Up to October 2010, these principles had only been adopted by the sovereign issuers from emerging markets. Since then, all sovereign issuers and those nonsovereign entities in which the state takes on a significant role in debt restructuring have also used them. The core guidelines are: data and policy transparency, open dialogue and cooperation, good-faith negotiations, and fair treatment (avoidance of discrimination) of all creditors (IIF, 2020a, 2021). These voluntary principles are to be adopted flexibly, on a case-by-case basis.

#### **Box 4: Examples for the application of the IIF Principles**

##### ***Use of the IIF principles under the Greek debt exchange***

The IIF principles for Stable Capital Flows and Fair Debt Restructuring aim to prevent debt crises and resolve them effectively through fair debt restructuring with a representative group of creditors. During debt restructurings two main principles are crucial: (i) to implement good-faith negotiations and (ii) to promote debtor-creditor dialogue and cooperation. In this way, the principles promote cooperation between debtors and creditors with a view to an orderly, timely and equitable restructuring. The voluntary debt exchange agreements for Greece (2012), Belize (2013), St. Kitts (2012), and Nevis (2012) were reached in line with these principles (IIF, 2012 and 2013).

The debt swap for Greece was historically unique up to that point because it was the first voluntary and negotiated debt restructuring before a debt default in mature economies. In addition, this debt exchange was up to that point the largest in history. Moreover, a heterogeneous creditor group including domestic and private investors as well as a number of public creditors were involved. Furthermore, the Greek sovereign debt crisis was associated with a high contagion risk for the stability of the Euro area and the international financial markets. Against this background, the cooperative, market-based guidelines enshrined in the Principles contributed significantly to this successful restructuring and brought benefits not only to the parties directly involved, but also to the Euro area as a whole and to global financial stability (IIF, 2013, p. 8). For managing the Greek debt crisis in 2012 the IIF principles were successfully applied because they formed the basis of the good – faith negotiations as well as a good debtor-creditor dialogue and cooperation between the private creditor representatives and the Greek officials on a voluntary restructuring of outstanding Greek public debt owned by domestic and foreign private creditors. The IIF principle “Good Faith negotiations” promoted the Greek debt exchange. For example, a creditor committee was established that was represented by a smaller Steering Committee of the Private Creditor–Investor Committee for negotiating the terms of the debt exchange. These Principles played a central role during the entire negotiations from June 2011 and the exchange of outstanding Greek national debts from domestic and foreign private creditors up to March/April 2012. As a result, a very high participation of private creditors was achieved (83.5%) and with the activation of the CAC, the participation of the creditors even rose to 97%. The successful completion of the voluntary debt restructuring allowed Greece both debt relief and breathing space.

This allowed the country to effectively implement the necessary economic reforms and made it more feasible to achieve debt sustainability (IIF, 2012).

### ***Application of the IIF principles to the European Stability Mechanism***

In addition, the IIF principles contributed to the modalities for private sector involvement in the European Stability Mechanism (ESM) that was established in 2011 as a response to the global financial crisis of 2008/2009 to channel financial assistance to member countries of the European Monetary Union (IIF, 2012, p. 3). The principles in the ESM are partly based on the IIF principles. These include, for example, the following principles that are similar to the IIF principles such as good faith negotiations, transparency and fairness. As with the IIF principles, the principles under the ESM seek a negotiation between states and the private sector in good faith. To ensure transparency debtor countries should conduct an open dialogue with creditors and provide relevant information to creditors in a timely manner. For enhancing fairness among creditors and debtors, the debtor should consult with the creditors on the arrangement of rescheduling or restructuring of public debt in order to find negotiated solutions. Approaches to reducing the net present value of debt are only considered if other approaches are unlikely to produce the expected results. The ESM principles also include a principle to improve cross-border coordination to take into account the risk of contagion and potential spill-over effects to other countries when developing the private sector involvement measures (EC, 2011, pp. 7–8).

The public sector—the IMF, the G20, the UN, the Banque de France, and the OECD—have also suggested or implemented various types of codes of conduct. This paper focuses on those proposals that have either been approved by a forum, such as the Principles put forward by the UN General Assembly and the G20, or that have been implemented, such as the IMF arrears policy and the OECD Principles. Since the proposal by Banque de France has neither been approved nor implemented by any forum, this proposal will not be examined in detail.<sup>11</sup>

The Fund's Lending into Arrears (LIA policy) that is valid for IMF's lending into sovereign arrears to private creditors also sets guidelines for responsible lending and borrowing for resolving debt crises and is legally enshrined in the IMF Articles of Agreement. The rationale of this policy is to support the balance of payment adjustment and, at the time, provide appropriate safeguards for the use of the Fund's financial resources as well as enable orderly debt restructuring to reestablish external viability (IMF, 2002, pp. 2–3 and 2013).

In 2008, the OECD Working Party on Export Credits and Credit Guarantees (ECG) was put in place and in 2016 the “Principles and Guidelines on Sustainable Lending for Low Income Countries” were updated. The main objective is to prevent unsustainable external debt levels of LICs by promoting sustainable lending practices of OECD members in providing official export credits to these countries. Although these Guidelines were converted in OECD Recommendations in 2018, their content has not changed significantly. These Guidelines/Recommendations have been in line with International Development Association (IDA) and IMF concessionality requirements and relate to the IFIs' debt monitoring and debt assessment instruments, including the IMF/WB country-specific debt sustainability analyses (DSAs), the IMF's Debt Limits Policy (DLP), and the IDA's Non-Concessional Borrowing Policy (NCBP). A close cooperation between the OECD Export Credit Group and the IMF/WB aims at guaranteeing that OECD members' credits do not endanger long-term debt sustainability (OECD, 2016 and 2018).

In 2017, the G20 established and committed to promoting the “Operational Guidelines for Sustainable Financing” (G20 Guidelines) for G20 countries’ sovereign borrowing in developing countries. These Guidelines aim at ensuring sustainable sovereign debt by promoting information-sharing and cooperation between debtors and creditors. They include five principles: (i) “Adequate financing for sustainable development,” (ii) “Information-sharing and transparency,” (iii) “Consistency of financial support,” (iv) “Coordination of stakeholders,” and (v) “Promotion of contractual and new financial instruments and minimizing litigation issues to strengthen resilience” (G20, 2017). At the end of 2018, the G20 asked the IMF and the WB to develop a voluntary diagnostic of creditors for implementing the Guidelines. This tool comprises a set of practices for the five principles of the Guidelines. In 2019, this tool was used by fifteen G20 members as well as by five non-G20 members to voluntarily assess their own compliance with the Guidelines (IMF and IDA, 2019, p. 3). However, it is not clear whether this tool will be applied regularly. In 2020, however, the G20 Guidelines were adopted to ensure transparency and disclosure of the terms of debt restructured under the G20 DSSI (IMF, 2020d, p. 11).

Since the 1970s the United Nations Conference on Trade and Development (UNCTAD) has worked on—and made several proposals for—sovereign debt restructuring. UNCTAD has had the general mandate to act as a central institution within the UN for debt issues. Within this mandate, the UNCTAD secretariat has had the task of formulating the annual UN General Assembly report on external debt in developing countries. The UN General Assembly resolutions on external debt challenges in developing countries have repeatedly considered debt restructuring as an instrument for resolving debt issues specifically, and the Assembly has called for improved approaches for dealing with sovereign debt problems (UNCTAD, 2015, pp. 14–15).

Against this background – and in view of missing legal frameworks on debt restructuring – UNCTAD proposed a “Roadmap towards Sustainable Sovereign Debt Workouts,” which also included five principles for sovereign debt workout: legitimacy, impartiality, transparency, good faith, and debt sustainability (UNCTAD, 2015). Additionally, in 2012, UNCTAD put in place the “Principles on Promoting Responsible Sovereign Lending and Borrowing” (UNCTAD, 2012). This paper focuses on the more recent UN proposal that has been put forward by the UN General Assembly (Guzman & Stiglitz, 2016; UN General Assembly, 2015) and which is based on the sovereign debt workout principles proposed by UNCTAD (Li, 2015, pp. 337–339) and the UNCTAD proposal made in 2015 (UNCTAD, 2015). In 2015, the UN General Assembly proposed and voted on a code of conduct (“Basic Principles on Sovereign Debt Restructuring Processes”) consisting of nine principles for sovereign debt restructuring: “the right of sovereign states to restructure their debt; sovereign immunity; good faith; transparency; impartiality; equal treatment; legitimacy; sustainability; and, respect for majority decision in restructuring processes” (UN General Assembly, 2015).

#### 4.1 | Different institutional settings of codes of conduct

A comparison of the general institutional settings of the abovementioned codes of conduct reveals that significant differences exist, leading to a fragmentation of the instruments used in the Global Debt Governance system. These differences are largely due to dissimilar objectives, the stakeholders addressed, different contexts and institutional processes, the scope of debt covered, the governance structure, and the relation to other instruments of the international financial architecture (Table 1).

TABLE 1 Comparison of the main features of the various codes of conduct

	IIF	OECD	IMF	UN General Assembly	G20 Guidelines
<b>1. Objective</b>	<p>“Promote financial stability and sustainable growth as well as supporting and preserving stable private capital flows”</p>	<p>“Ensure that OECD Members’ credit decisions do not contribute to debt distress in the future”</p>	<p>The Lending into Arrears (LIA) policy seeks to support effective adjustment while facilitating orderly debt restructuring to restore external viability</p>	<p>Management and resolution of financial crises</p>	<p>“... enhance access to sound financing for development while ensuring that sovereign debt remains on a sustainable path ...”</p>
<b>2. Context and institutional process</b>	IIF and emerging market sovereigns	OECD Export Credit Group	IMF: sovereign debt restructuring and LIA policy	UN General Assembly 2015 based on results of the UN Working Group: sovereign debt workout	G20 meeting: reference to UN Financing for Sustainable Development process
<b>3. Legal status</b>	No legal status	No legal status	Legal status, Articles of agreement	No legal status	No legal status
<b>4. Stakeholders</b>					
<b>a) Debtor eligibility</b>	a) All countries, public obligors	a) LICs, public obligors or publicly guaranteed obligors	a) IMF member countries	a) All sovereign countries, international and national levels	a) Developing countries, sovereign
<b>b) Creditor</b>	b) Private	b) OECD members	b) Broadening creditor coverage over time; currently private creditors and official bilateral creditors	b) All creditors	b) G20 countries

(Continues)



TABLE 1 (Continued)

	IIF	OECD	IMF	UN General Assembly	G20 Guidelines
<b>5. a) Proposal</b>	a) 2004	a) 2008	a) 1970	a) 2015	a) 2017
<b>b) Implementation</b>	b) Since 2005	b) Since 2008	b) Since 1970		
<b>6. Scope/Type of debt</b>	Public debt owed to private creditors	Official export credits $\geq 1$ year	Broadening creditor coverage; currently debt of private creditors and official bilateral creditors	Sovereign debt	Sovereign debt
<b>7. Governance structure</b>	Group of Trustees Principles Consultative Group	ECG members will monitor concessionality requirements and report to the IMF and the IDA	IMF Executive Board	-	Diagnostic Tool for voluntary evaluation of compliance with the Guidelines
<b>8. Link to other instruments /institutions of the international financial architecture</b>	IMF instruments: DSAs, DSF, lending into arrears policy Link to CACs	Close cooperation with IMF/WB DSAs, DSF, DLP, NCBP; follow IDA and IMF concessionality	Close cooperation with Paris Club, London Club, G7, G20, IMF member countries	States should be encouraged to include CACs in their sovereign debt to be issued <sup>9</sup>	IDA/IMF instruments: DSA, DSF, DLP, NCBP, DMF; UNCTAD DMFAS; CACs, parti passu clause, GDP-indexed instruments

Source: Own design based on Banque de France, 2003; IIF, 2021; OECD, 2016; UNCTAD, 2015; UN General Assembly, 2015; G20, 2017; IMF, 2002, 2015a, 2015b.

The codes of conduct had been proposed in different contexts and by different public and private institutions, partly entailing different objectives. The proposals of the UN, the G20, and the OECD mainly aim at either ensuring debt sustainability or promoting sustainable debt workouts. In addition, the objective of the IIF code of conduct is to maintain private capital flows and enhance financial stability and sustainable growth.

The proposals of the UN address all sovereign debtors and creditors, be they private or public. By contrast, the OECD Guidelines only include LICs as debtors and OECD members as creditors. In a similar way, the G20 Guidelines include only developing countries as debtors and the G20 countries as creditors.

The IMF's arrears policy has been the only code of conduct that has been based on legal principles aiming at preventing difficulties to the international trade and payments system.<sup>12</sup> Although the other codes of conduct do not have legal status, some of them have been approved by stakeholders or have signaled other commitments to adhere to the respective code of conduct. For instance, European Union (EU) members have approved the OECD Guidelines. Nearly all UN member states voted for the UN General Assembly resolution; only six countries (Canada, Germany, Israel, Japan, the United Kingdom, and the United States) voted against the resolution (UN General Assembly, 2015). Similarly, the G20 countries agreed on the G20 Guidelines.

Moreover, the codes of conduct under review cover different types of debt. The UN and G20 proposals include only sovereign debt, whereas the IIF code of conduct only covers sovereign debt owed to private creditors. By contrast, the OECD proposal only addresses OECD members' official export credits offered to LICs with a repayment term of 1 year or more.

Currently, the Fund's arrears policy applies to private and official bilateral debt. However, the Fund's arrears policy has been evolving since 1970, and the criteria for Fund lending into arrears to private and official creditors have changed over time on a case-by-case basis. In the aftermath of the debt crises of the early 1980s, the Fund reformed this policy by accepting arrears to external private creditors during a Fund program—the so-called Lending into Arrears (LIA) policy—given two prerequisites: (i) immediate financial support of the Fund is crucial for successfully implementing the member's adjustment program, and (ii) the member conducts adequate policies and searches for a “good faith” agreement with its creditors (IMF 1999; 2013, pp. 11–12 and p. 47, and 2015a, pp. 6–7). In contrast, for official bilateral creditors, the Fund applied a nontoleration policy of official bilateral or multilateral arrears. In view of the changing composition of official finance, the Fund reformed its nontoleration policy to official bilateral creditors in 2015 to ensure that the Fund can provide financial support in cases where bilateral official creditors are unwilling to take part in restructuring processes.<sup>13</sup> The IMF allowed for lending to unresolved official bilateral arrears that are restructured in the framework of an IMF-supported program. The Fund established a two-step approach. In the first step, the debtor and creditors should achieve common agreement. In case agreement among the creditors—who represent a significant portion of total official bilateral claims—is not reached and an agreement cannot be achieved with each creditor in alternative groups or bilaterally, the Fund should take into account lending into arrears to official bilateral creditors. In this case, three criteria need to be met: (i) the debtor conducts negotiations in good faith, (ii) the restructuring maintains the Fund's ability to provide financial resources in the future, and (iii) the Fund's Executive Board approves this lending into arrears on a case-by-case basis (IMF, 2015a, 2015b).

On the one hand, a code of conduct encompassing all types of debt would be more effective for resolving sovereign debt crises. On the other hand, it is easier to monitor and implement a code of conduct covering only one specific type of debt, as in the case of the OECD Guidelines. This might

also be one reason why only three of the codes of conduct under review have been implemented – the IIF, the LIA and the OECD codes of conduct.

Whereas the UN proposals do not include a monitoring – or even more binding – governance framework, the IIF, the IMF, the OECD, and the G20 codes of conduct comprise monitoring or governance procedures. Among these, the IMF and the IIF codes of conduct include the most thorough governance frameworks. The IMF arrears policy is monitored for each member country's program. A Group of Trustees reviews the implementation of the code of conduct and supervises the work of the Principles Consultative Group (PCG). This group monitors the principles and promotes their application. Both groups consist of finance and central bank officials as well as senior representatives of the private financial sector (IIF, 2021). The members of the ECG monitor the concessionality requirements and report to the IMF and IDA (OECD, 2016 and 2018). Since most of the proposed codes of conduct are voluntary, a good governance framework is necessary to ensure the effectiveness of the codes.

Most of the codes of conduct take other instruments of the Global Debt Governance system into account. In their codes of conduct, the IIF, the UN, and the G20 consider CACs and the *pari passu* clause in addressing collective action problems. Instruments of the IFIs, such as the DSF and DSAs, are taken into account by the IMF, OECD, the IIF, and the G20 proposals. In addition, the European Commission (EC) demands in its position to the UN General Assembly proposal that the work of an ad hoc committee should take into account the work of the IMF, its technical support and also the work of the Paris Club (EC, 2015, p. 3). To enhance the effectiveness of codes of conduct, they need to be linked to other instruments of the Global Debt Governance system.

The codes of conduct would be more effective and efficient if they were unified with regard to the criteria discussed above. The codes of conduct need to be more consistent in order to ensure long-term debt sustainability. Different institutional settings and different principles do not contribute effectively to managing and resolving debt crises because the actors concerned apply diverging codes of conduct.

## 4.2 | Principles for codes of conduct

The key principles incorporated in most of the codes of conduct<sup>14</sup> are legitimacy, impartiality, negotiation in good faith, fair treatment, equal treatment of all creditors, fair creditor representation/majority restructuring, dialogue between debtors and creditors, transparency, and debt sustainability.<sup>15</sup>

The main function of principles is to assume the role of frames in so far principles limit the degree of interpretation of abstract legal rules and close gaps in the written law and unwritten rules. In this way, principles combine specific legal or policy choices with the general legal and economic orders as well as with the institutional frameworks (UNCTAD, 2015, pp. 18–19).

The main difference between the codes of conduct is not only that they are based different principles, but also that the content of these principles is not the same, that is, these principles have different features in the various codes of conduct. In cases where the principles have different characteristics, this could lead to problems in the implementation of the codes of conduct, as creditors and debtors have to apply different principles contained in the codes of conduct to the same sovereign debt restructuring. There is a risk that the creditors and debtors will apply the principles that are associated with fewer requirements and less effort. This race to the bottom could make the codes of conduct less effective.

Below, the main principles that are laid out in the various codes of conduct are compared and assessed.<sup>16</sup> Although the principles are interrelated and overlap to some extent, they cannot be seen as substitutes for each other but rather as complements. Common features in different principles would underline the significance of these specific characteristics.

#### 4.2.1 | Legitimacy

The principle “legitimacy” is incorporated in two codes of conduct under review (UN General Assembly, 2015; UNCTAD, 2015). The principles proposed by the UN General Assembly are mainly based on the UNCTAD principles and represent a much shorter version of the latter. According to the principles proposed by the UN General Assembly, legitimacy indicates that the operations and the setting up of institutions associated with sovereign debt restructuring workouts must be inclusive and respect the rule of law at all levels. In addition, the terms and conditions of the original contracts should continue to be in force until they are amended under a restructuring agreement (UN General Assembly, 2015, p. 2).

In the context of sovereign debt workout, UNCTAD differentiates between two dimensions of legitimacy: (i) Source legitimacy demands that international institutions which are put in place comply with inclusiveness and the rule of law, insofar that they are similar to the features of legitimacy of the UN General Assembly; in addition, source legitimacy requires that all relevant stakeholders are included in the processes and that there is transparency; (ii) Process legitimacy requires that a debt workout process is inclusive, complies with the rule of law, is predictable, is comprehensive with regard to covering the entire outstanding debt, includes reasoned decisions, respects the ownership of the debtor country, and is subject to legal review (UNCTAD, 2015, p. 20).

According to UNCTAD (2015, p. 19), legitimacy “is the property of a legal rule or a legal regime which makes it acceptable to its addressees, thereby inducing compliance.” A further feature of legitimacy is that it is not a category that can be either met or not met: Meeting legitimacy is “a matter of degree.” Legitimacy—in the context of sovereign debt workout—should contain the following issues: respect for the rule of law, inclusive decision-making, and human rights (UNCTAD, 2015, p. 20). In this respect, legitimacy provides an incentive for debtors and creditors to follow rules, laws, or regimes during debt restructurings and thereby leading to a timely, transparent and fair debt restructuring procedure. This would contribute to long-term debt sustainability.

Due to its broad and inclusive features, legitimacy overlaps to some extent with most of the other principles such as transparency, legitimacy, good faith, and equitable treatment.

#### 4.2.2 | Impartiality

By the same token, a similar definition of “impartiality” is included in two codes of conduct proposed by UNCTAD (2015) and the UN General Assembly (2015). Impartiality demands that actors, institutions, and information relevant to debt restructuring are neutral. In this way, impartiality advances trust among creditors and the debtor and institutions involved that would in turn contribute to fair and transparent debt restructuring. In this regard, impartiality is interrelated with legitimacy, transparency, and the good faith principle. Although the exact content of impartiality and its scope differ in various jurisdictions and institutions, it is inherent to the rule of law (UNCTAD, 2015, p. 21).

Within the context of debt restructuring, UNCTAD differentiates between three dimensions of impartiality: (i) Institutional impartiality: Institutions taking part in debt workouts should be independent, for example, with regard to financial situations and the decision-making process; (ii) Actor impartiality: Actors involved in the assessment and review of debt situations should not receive any directions from debtors, creditors, or third parties; and (iii) Informational impartiality: Institutions involved in sovereign debt workouts should only receive information that is not affected by the interests of any party participating in the process, for example with respect to the use of debt indicators or any debt assessment. By using information from different sources and high-quality data, informational impartiality could be ensured (UNCTAD, 2015, p. 21).

Similarly, in the proposal made by the UN General Assembly, impartiality demands that all institutions and actors participating in sovereign debt restructurings—that also means institutions at the regional level—are in line with their mandates and should avoid any undue influence regarding the process and other stakeholders (UN General Assembly, 2015, p. 2).

In practice, it is difficult to meet impartiality requirements entirely because some institutions involved in the debt restructuring process, such as creditors—particularly the IMF and the WB—have valuable expertise on debt assessment and debt management at their disposal. In addition, these institutions also possess crucial data that are necessary for the debt restructuring process. As laid out in the previous section, in their principles, most of the codes of conduct include links to instruments of the IFIs because these provide crucial instruments and data for resolving debt crises. By assuming two roles—as creditors and as experts—often IFIs do not actually fulfill the impartiality requirements. According to UNCTAD (2015, p. 21), one possible way to address this problem would be to consider several resources for debt sustainability assessments or to apply high-quality data. A further solution would be to discuss the IFIs' debt sustainability assessments with an independent group of experts nominated by all debtors and creditors involved in the debt-restructuring process.

According to the EC (2015, p. 4), a further problem of the principles proposed by the UN General Assembly is that they require that “all institutions and actors involved in sovereign debt restructuring including at regional level . . . refrain from exercising any undue influence over the process and other stakeholders engaging in actions that would give rise to conflicts of interest.” The EC criticizes, that this statement does not correspond, on the one hand, to the institutional framework of the EU and, on the other hand, to its practical circumstances, in which any debates on the debt level of a member state are mainly conducted at the regional level, while the member states themselves frequently represent the key creditors (directly or via the financial support mechanisms they have set up).

#### 4.2.3 | Good faith

Although a number of codes of conduct comprise the principle “good faith,” the content differs in the various proposals. According to UNCTAD (2015, pp. 22–23), key components of good faith are honesty, fairness, and trustworthiness. Good faith is relevant for the substance and the process of sovereign debt workouts. With regard to substance, good faith means that the legal and economic outcomes of sovereign debt resolutions should fulfill legitimate expectations. With respect to the process of sovereign debt workouts, several aspects are crucial, including equality, namely intercreditor equality; standstill on payments; stay on litigation; good faith negotiations including no unjustified exclusion of creditors; duty to negotiate, namely duty of creditors and debtors to

negotiate in the case of unsustainable debt, conflicts of interest, and the exclusion of abusive creditor holdouts. Therefore, good faith interrelates with some of the principles including legitimacy, equitable treatment and sustainability.

In line with the proposal made by the UN General Assembly, good faith by the sovereign debtor and all its creditors would demand that these actors conduct constructive sovereign debt restructuring negotiations to ensure timely and long-term debt sustainability. Equally important is that the majority of creditors conduct a constructive dialogue with respect to the debt-restructuring terms (UN General Assembly, 2015, p. 1).

In the same vein, good faith under the IIF Principles means that debtors and creditors should guarantee timely good faith negotiations if debt restructuring is inevitable (IIF, 2021, pp. 56–57). Similarly, the G20 Guidelines require debt restructuring to be managed in good faith, that is, in a timely, orderly, and effective way that ensures adequate burden-sharing (G20, 2017, p. 2). Although the IIF does not define when debt restructuring is inevitable, it proposes that a restructuring process should be based on sound policies that intend to provide opportunities for renewed market access, sound macroeconomic growth, and the balance of payments sustainability in the medium term. In this regard, debtors and creditors should urge the IMF to fully apply its guidelines for lending into arrears to private creditors in existing IMF programs, including the requirement for good faith agreements (IIF, 2021, p. 56)

A further important element of good faith in the IIF Principles is the sanctity of contracts, that is, that contracts should be maintained and modified only if both parties approve a change. As vehicles for restructuring, creditor committees should be established. The members of these committees should be formed flexibly and on a case-by-case basis. In addition to that, the IIF defines some debtor and creditor actions during restructuring that contribute to good faith: (i) Debtors should pay partial debt service payments and full payment of principal and interest, to the extent possible, and (ii) debtors and creditors should warrant that trade lines are serviced completely and maintained during debt restructuring (IIF, 2021, pp. 56–57).

With regard to the IMF arrears policy, good faith clause should contribute to reaching a collaborative agreement by conducting a “timely and substantive dialogue between a debtor and its creditors” during the process. The two main aims concerning the debtor-creditor relationship are: (i) to attain abroad participation of creditors in debt restructurings and (ii) to promote the efficient functioning of capital markets in a broad sense, that is, implement a predictable debt restructuring process that enhances the probability of not adversely affecting asset class. General principles include that the debtor should initiate dialogue early with its creditors and that this dialogue should continue until the debt restructuring ends. The debtor should provide complete and relevant information about its financial and economic situation with all creditors on a timely basis. The debtor should give creditors the opportunity at an early stage to discuss and make proposals for debt restructuring strategies (IMF, 2002, pp. 9–10 and IMF, 2013, p. 47).

Comparing these proposals, it becomes obvious that good faith has been defined differently in the various codes of conduct, and that significant room for interpretation remains. One common feature, for example, is that debtors and creditors should ensure timely good faith negotiations for debt treatments that is essential for attaining debt sustainability. All actors would benefit from good faith negotiations and trust among the actors would increase. For this reason, it would be essential to elaborate a common definition for this principle. These requirements for good faith are interrelated with legitimacy, transparency, and impartiality.

#### 4.2.4 | Equitable treatment

In various codes of conduct, the principle of “equitable” or “fair treatment” is included. Examples are the UN General Assembly and IIF proposals. In the UNCTAD proposal, intercreditor equality is also incorporated into the principle of good faith (UNCTAD, 2015, p. 23). However, the core content of equitable or fair treatment varies in the codes of conduct.

The suggestion made by the UN General Assembly requires that sovereign debtor states should not discriminate among creditors, as long as the law does not justify different treatment and it is related to the features of the credit. Moreover, the different treatments need to be discussed among all creditors, which have the right to receive proportionate treatment in line with their credit and its features. None of the creditors or creditor groups should be left out of the sovereign debt restructuring process *ex ante* (UN General Assembly, 2015, p. 2). However, the EC criticizes this equitable treatment because it precludes the preferred creditor status of the IFIs in the case of providing credit to states in critical debt situations, as in the case of the lending-into-arrears policy of the IMF (EC, 2015, p. 5).

Similarly, the IIF fair treatment principle of creditors includes prevention of unjustified discrimination among the creditors concerned. According to the IIF, restructuring should be required for all official bilateral debts and short-term trade-related facilities, interbank loans should not be restructured and dealt with separately (IIF, 2021, p. 57).

Whereas the UN General Assembly and the UN proposals require that creditors should be treated equally, the IIF and the EC demand the preclusion of various types of creditors. However, by excluding some types of debt an equitable treatment is not guaranteed. This could lead to collective action problems on the part of the creditors including hold-out problems and litigation of creditors. These collective action problems impede an effective debt restructuring and thereby endanger debt sustainability. The G20 Guidelines require that official creditors should meet their commitments and that private creditors adequately participate in providing debt relief if needed (G20, 2017, p. 2).

While equitable treatment is one crucial prerequisite for an equal burden sharing among creditors intercreditor equality is difficult to ensure and to realize. Often selective sovereign defaults took place and only specific types of debt were restructured. Selective sovereign defaults often do not comprise both domestic and foreign law debt instruments, as shown in Erce and Mallucci (2018), Erce et al. (2020), and Erce et al. (2022). Around half of the sovereign defaults under local law took place simultaneously with defaults under foreign law. Likewise, only a quarter of foreign law defaults happened at the same time with domestic defaults (Erce et al., 2020, p. 3).

A further principle put forward by the UN General Assembly related to fair treatment is “majority restructuring,” indicating that sovereign debt restructuring agreements of a qualified majority of the creditors of a state should not be modified, put at risk, or otherwise inhibited by other states or a nonrepresentative minority of creditors. The latter is bound to respect the decisions taken by the majority of the creditors (UN General Assembly, 2015, p. 2). The EC has criticized this guideline because issuances under foreign jurisdictions include agreeing to decisions taken by the courts of another state (EC, 2015, p. 5). The IIF incorporates a second aspect – the fairness of voting. Accordingly, votes agreed among creditors on debt restructuring should not be affected by bonds, loans, or other financial instruments that belong to—or are controlled by—the sovereign debtor (IIF, 2021, p. 57).

Again, the core content—the scope of debt covered under a sovereign debt restructuring—as well as the voting procedures are dissimilar in the codes of conduct under review. Hence, the

actors involved should agree on the scope of the debt covered and on the voting procedures to be applied.

#### 4.2.5 | Debtor-creditor dialogue and cooperation aimed at avoiding restructuring

The principle regarding a debtor-creditor dialogue is included in all codes of conduct under review. This principle is often part of the good faith criterion and is repeatedly related to transparency. The good faith criterion incorporated in the Fund's arrears policy requires that the debtor enter in an early dialogue with creditors after having decided that a debt restructuring is needed and until the end of it (IMF, 2013, p. 47). Similarly, the UN General Assembly Principles include in their good faith criterion a constructive dialogue with respect to debt restructuring terms (UN General Assembly, 2015, p. 2). A regular debtor-creditor dialogue enhances trust among the debtor and the creditors and contributes in this way to effective debt restructurings.

The IIF has established a principle that should promote regular debtor-creditor dialogue and cooperation to avoid debt restructuring. This principle includes a regular dialogue on core economic and financial policies. It also contains best practices for investor relations, including an investor-relations office (IIF, 2021, p. 55).

The G20 Guidelines also call for a "coordination of stakeholders" by conducting a regular dialogue between sovereign creditors, debtors, and IFIs prior to and during debt crises. The G20 supplements this by demanding coordinated policies between IFIs to ensure financial sustainability (G20, 2017).

#### 4.2.6 | Transparency

The majority of the codes of conduct incorporate transparency as a principle. Although the content differs in various proposals, the main objective of enhancing transparency on the debt situations is mainly the same. For this reason, there is largely agreement on this principle among the proposals discussed. Transparency ensures that information on the operations of public authorities is accessible to the public and all stakeholders. In this regard, transparency is linked to the rule of law and legitimacy.

The role of transparency differs in crisis prevention and crisis management and is more significant for the latter. In the crisis prevention phase, transparency improves for example the flow of information between creditors and debtors and can support preventive measures, such as in debt management. However, higher transparency cannot prevent debt crises that are triggered by external shocks, for example. In the crisis management phase transparency and the timely flow of information on the debtor's financial position and its agreements with other creditors also increases trust among the actors and simplifies debt restructurings.

UNCTAD proposes two dimensions of transparency: (i) Data transparency—this includes transparency on data on debt sustainability, particularly the provision of accurate data on a country's debt situation, on projections underlying suggested debt restructurings including indicators, and data on the debt held by creditors, and (ii) Institutional and process transparency—this needs to be balanced against confidentiality requirements in specific situations (UNCTAD, 2015, p. 22). Similarly, with the UN General Assembly proposal, the main objective of transparency is to increase the accountability of the actors taking part in the debt restructuring through the timely



sharing of data and information on the processes associated with sovereign debt workouts (UN General Assembly, 2015, p. 2).

By the same token, the IIF includes a principle on transparency and the timely flow of information on debt situations that also includes transparency on the debtor's financial position and its agreements with other creditors (IIF, 2021, p. 55). Similarly, the good faith criterion included in the Fund's arrears policy demands that the debtor timely discloses relevant information with all creditors (IMF, 2013, pp. 47–48).

For their part, the G20 Guidelines incorporate a principle called information-sharing and transparency that also requires transparency to be promoted with respect to macroeconomic indicators and debt sustainability assessments, as well as relevant cases of past sovereign debt restructurings. According to these guidelines, it is crucial that sovereign creditors and debtors develop a “common understanding of the macroeconomic and financial situation” of the sovereign debtor. The G20 proposes including the instruments of the IFIs, such as the DSAs (G20, 2017, p. 1).

#### 4.2.7 | Debt sustainability

Most of the codes of conduct include debt sustainability as a principle. Although debt sustainability is defined differently in various proposals, the main two objectives of achieving sustainable debt levels and sustainable development are similar. Since debt sustainability can only be achieved when transparency and the timely flow of information on debt situations are ensured, this principle is closely related to requirements for transparency.

For attaining debt sustainability the UN General Assembly includes the following requirements for debt restructurings: (i) debt restructurings should be concluded timely and efficiently; (ii) entail a stable debt situation; (iii) maintain creditors' rights; (iv) endorse sustainable development as well as sustained and inclusive growth; (v) minimize economic and social costs; (vi) ensure a stable international financial system; and (vii) respect human rights (UN General Assembly, 2015, p. 2).

UNCTAD (2015, p. 24) defines sovereign debt as sustainable when it can be serviced without weakening the social and economic development of the debtor state. It differentiates between procedural and substantive sustainability. With regard to procedural sustainability, sustainability forms a standard for the debt workout process concerning the timeliness of the need for debt workouts and its efficiency with regard to ensuring a timely debt resolution. Substantive sustainability indicates that sustainability represents a standard for the results of debt restructurings, incorporating restructuring terms, the type of indicators, and structural adjustment programs. According to this proposal, debt sustainability includes financial sustainability as well as economic and social sustainability.

The objective of the G20 Guidelines is to improve access to sound financing for development and secure sovereign debt sustainability. This G20 proposal includes one guideline termed “adequate financing for sustainable development,” which mainly refers to debt sustainability and requires the provision of adequate financial support with the aim of achieving or maintaining both sustainable development and debt sustainability. This is also closely related to a further G20 Guideline named “consistency of financial support” indicating that debtors and creditors are jointly responsible for consistent borrowing and lending practices. The G20 countries are to apply the IMF's Debt Limits Policy and the IDA's Non-Concessional Borrowing Policy. Along with this, creditors should provide technical assistance to debtor countries—either directly or through international institutions—by promoting debt management capacities (G20, 2017).

The OECD recommendations require that providing official export credits should be in line with sustainable lending practices that contribute to debt sustainability. Lending should contribute to debtor countries' economic and social progress without threatening the financial future and long-term development prospects (OECD, 2018, p. 2).

In the IIF principles a clear definition for debt sustainability is not included. The Principles assign the IMF an important role in the analysis of debt sustainability by providing an assessment of the macroeconomic situation and the funding needs of sovereign debt. Moreover, some prerequisites for attaining debt sustainability are mentioned including the early reestablishment of market access. By issuing bonds at reasonable costs on international markets sovereigns can reduce external public financing from IFIs and bilateral official creditors. A further prerequisite for debt sustainability is an early discussion among creditors, the debtors and the official sector on a multiyear macroeconomic framework and objectives because this discussion would make agreements on debt restructuring easier and contribute to regained market access and renewed output growth (IIF, 2021, pp. 60–61).

In sum, for achieving debt sustainability a large number of requirements for debt restructurings are outlined in the UN proposals including economic, financial as well as social and human rights requirements. The G20 Guidelines and the OECD recommendations are complementary to these requirements by adding conditions for adequate and sustainable financing. These two Guidelines and the IIF Principles explicitly refer to the IMF instruments to monitor and assess debt sustainability in developing countries. The IIF principles do not mention social and human rights requirements or inclusive sustainable development as requirements for achieving sustainable debt.

Since the core content, scope, and significance of the various principles are not standardized in the codes of conduct proposed, it would be necessary to align these principles.

## 5 | PROPOSAL FOR AND STEPS TOWARD IMPLEMENTING A (UNIVERSAL) CODE OF CONDUCT

In responding to the COVID-19 crisis, government expenditures in the whole world have significantly risen. Since debt levels in all types of countries were already high prior to the COVID-19 crisis a large number of countries have been in debt distress in the aftermath of the COVID-19 crisis. In view of protracted and costly sovereign debt restructurings in the previous decades, existing instruments of the Global Debt Governance architecture are insufficient to prevent and to ensure effective, comprehensive, fair, and transparent sovereign debt crisis resolutions.

While statutory and comprehensive approaches to resolve sovereign debt crises lack the political support incomprehensive contractual approaches including CACs cannot fully secure a comprehensive and timely debt resolution. Despite reform proposals to amend CACs and to broaden their use to other types of debt (subsovereign debt syndicated loans), codes of conduct could constitute an essential instrument to contribute to preventing and resolving sovereign debt crises. With regard to crisis prevention, codes of conduct should prevent a debt crisis by increasing transparency and ensuring a timely flow of information among the debtors and creditors. Similarly, a close debtor–creditor dialogue should contribute toward avoiding debt crises. Concerning debt crisis resolution codes of conduct contribute by facilitating restructuring procedures because they enhance the predictability and transparency of the negotiation processes and strengthen cooperation between creditors and debtors. Moreover, codes of conduct assume a crucial complementary

role to other instruments of the Global Debt Governance system, including CACs and statutory approaches such as insolvency procedures.

However, a unified code of conduct that is valid for all creditors and debtors need to be established. Since several codes of conduct have been proposed or even put into place, their ultimate effectiveness is endangered because debtors and creditors may refer to differing codes of conduct (Berensmann, 2017). It is necessary to align the different proposals that already exist and establish one unified code of conduct that is valid for all creditors and debtors. The analysis of the previous two sections forms the basis of a proposal for and steps toward implementing a (universal) code of conduct.

Below, we propose an institutional setting along with a set of principles for all market participants, both before and during a debt crisis. The setting and the principles would form the basis of a newly designed code of conduct that takes into account as many interests of the various actors as possible, because one key prerequisite for an effective implementation of the code of conduct is that there is broad consensus among stakeholders on its design. In this new code of conduct, the elements of the various proposals made by the public and private sectors would be combined as far as possible.

## 5.1 | Proposal for an institutional setting of a unified code of conduct

An aligned code of conduct should have the following general institutional setting: with regard to the objective, the code of conduct should aim at ensuring debt sustainability by preventing and promoting sustainable debt workouts. Concerning stakeholders, debtor eligibility and creditors, all sovereign debtors and all public and private creditors should be involved in a debt workout procedure. As a comprehensive approach, all types of debt should be covered. With regard to the legal status, the codes of conduct should be nonstatutory.

However, incentives should be set so that actors in the international financial markets are encouraged to adhere to it by means of a governance framework. A monitoring system with the objective of reviewing the implementation of the new code of conduct should be put in place (Gelpern, 2013, pp. 359–60, p. 380). As already takes place in the case of the IIF principles, a Group of Trustees could review the implementation of the code of conduct and supervise the work of the PCG (IIF, 2020a, 2021). This later group could monitor the principles and promote the application of the universal code of conduct. Both groups would consist of the debtor, the public- and private-sector creditors, as well as representatives from nongovernmental organizations. Gelpern (2013, p. 381) also proposes to establish a secretariat to foster the institutional structures of the code of conduct.

The code of conduct should be linked to other instruments of the international financial architecture: the universal code of conduct should be related to the existing instruments of the Global Debt Governance framework such as CACs, the *pari passu* clause, IMF/WB Debt Sustainability Analysis, the DSF, the Fund's Debt Limits Policy and the World Bank's Sustainable Development Finance Policy. Gelpern (2013, p. 352) proposed for UNCTAD the "Principles on Promoting Responsible Sovereign Lending and Borrowing" to involve public actors such as the IMF, the Paris Club, the Financial Stability Board, and the Bank for International Settlements, as well as private-sector cooperations such as the International Capital Market Association, the Securities Industry and Financial Markets Association, and the IIF. The public and private actors should be included in the surveillance, technical assistance, and other issues regarding the operation of the proposed code of conduct.

## 5.2 | Proposal for the principles of a unified code of conduct

The core elements of a universal code of conduct should resemble the main principles incorporated in the diverse codes of conduct discussed above: (i) legitimacy, (ii) impartiality, (iii) negotiation in good faith, (iv) equal treatment, (v) fair creditor representation, (vi) dialogue between debtors and creditors, (vii) transparency, and (viii) restore debt sustainability (Banque de France, 2003; G20, 2017; IMF, 2002, 2015a and 2015b; OECD, 2016; UN General Assembly, 2015; UNCTAD, 2015). Although this set of principles should have a normative character to ensure a fair, transparent, efficient, and effective debt resolution, we aim to include the issues of the various proposals that overlap most in defining these principles within the context of debt workout. We propose that the principles of a universal code of conduct should be defined and implemented as follows:

**Legitimacy** implies that the operations and the institutions involved in sovereign debt restructuring should be inclusive, and that they should respect the rule of law at all levels. Debtors and creditors should honor existing contracts.

**Impartiality** means that actors, institutions, and information remain neutral during debt restructurings, and that they should not be influenced by other stakeholders. As far as regional institutions are affected, creditors and debtors should be required to seek an agreement.

**Debt restructuring in good faith** means that a timely, orderly, and effective solution to ensure debt sustainability as well as adequate burden-sharing and intercreditor equality should take place. In addition, contracts should be preserved for as long as possible. One illustration of evidence for good faith behavior is that parties concerned comply with the code of conduct. Further procedures could also signal good faith action, including an agreement among creditors on a concerted standstill and a stay on litigation.

**All creditors should be treated equally**, and no creditor or creditor group should be precluded from the sovereign debt restructuring process. One exception to this general rule is in the case of lending into arrears: creditors who lend in the case of debt distress may be excluded from debt restructuring. However, different options for treatments need to be agreed among all creditors concerned. Other principles such as good faith, fair representation of creditors, debtor-creditor dialogue, and transparency would support the equal treatment of creditors.

**A fair representation of creditors** needs to be ensured during debt restructuring. Existing instruments of the Global Debt Governance framework, such as CACs, should be applied. In cases where CACs are not—or only partly—included in the sovereign debt, a qualified majority of 75 percent should be applied.

**Debtor-creditor** dialogue should be promoted both prior to and during a sovereign debt crisis. One option to implement several principles – debtor-creditor dialogue, information-sharing, and transparency – is to establish a Sovereign Debt Forum, as proposed by Gitlin and House (2014), that is a neutral standing body to ensure timely and discrete dialogue and information-sharing between the parties involved. In the same vein, it would enhance transparency.

**Transparency** of the debtor's financial position and its agreements with other creditors as well as a timely flow of information on the debt situation are needed. The debtor should provide its creditors adequate information on the debt situation (outstanding debt), and on the economic and financial circumstances that generated the need to restructure debt.

The main objective is to maintain the debtor's financial situation and restore **debt sustainability** as soon as possible after a debt crisis. This principle is closely linked to transparency because debt sustainability can only be reached when transparency and the timely flow of information on debt situations are ensured. For meeting this principle, an independent group of experts

nominated by all debtors and creditors involved in the debt-restructuring process should conduct debt sustainability assessments that take into account the IFIs' debt monitoring and assessment instruments, including IMF/WB Debt Sustainability Analysis, the DSF, the Fund's Debt Limits Policy and the World Bank's Sustainable Development Finance Policy. Debt sustainability assessments should be based on the data and assessment tools of the IMF and World Bank including the Debt Sustainability Analysis and the DSF. While these institutions assume two roles – as creditors and as analysts – they have valuable expertise on debt assessments and possess valuable data. For this reason, it is difficult to fulfill impartiality requirements entirely in practice. In addition, creditors should provide technical assistance to debtor countries either directly or through IFIs' debt management tools, such as UNCTAD's Debt Management and Financial Analysis System and the IMF/WB Debt Management Facility.

A core prerequisite of a cooperative process and ownership is the active participation of all stakeholders in elaborating a code of conduct (Banque de France, 2003, p. 14). The parties affected—including creditors, debtors, and the public sector—should contribute to the design, approval, and implementation of a new aligned code of conduct by putting in place an expert group that includes representatives of all parties. In a first step, the parties could agree on the composition and tasks of the expert group. In a second step, this expert group could elaborate a proposal for a code of conduct that would be approved by all parties. The relevant public and private actors should adopt the following tasks: the public and private sectors—including representatives of IFIs—should take on an active role in the governance body; developing countries, on the other hand, should signal their willingness to apply the code of conduct by means of incorporating it in the documents for sovereign bond issues (Berensmann, 2017).<sup>17</sup> In addition, it would be important to embed this code of conduct in the national and international hard laws as well as in the international cooperation infrastructure, that is, the G20, the G77, or the Financial Stability Board (Gelpern, 2013, p. 351).<sup>18</sup>

In the same vein, the global economic governance structure should include incentives for creditors and debtors to adhere to this new universal code of conduct. If market participants regard the application of, and adherence to, the new code of conduct as a means of enhancing their reputations and, accordingly, as a means of improved access to international financial markets, it is in a sovereign debtor's own interests to comply with this code. In this respect, peer and market pressure would play a crucial role. Measures to put pressure on the creditors and debtors to apply the code of conduct are: (i) the publication of a country list indicating the countries adhering to the code of conduct (Banque de France, 2003, p. 14), (ii) encouraging rating agencies to consider adherence to the code of conduct in their macroeconomic analyses (Ritter, 2009, p. 25), (iii) incorporation of the code of conduct into sovereign bond contracts (Banque de France, 2003, p. 14), and (iv) inclusion of codes of conduct in the lending policies of the IFIs, such as in the lending-into-arrears policy of the IMF (Banque de France, 2003, p. 14) or as performance criterion at the IMF.

In the medium term, an appropriately designed code of conduct can contribute to the effective, efficient, comprehensive, fair, and transparent resolution of sovereign debt crises. One main prerequisite for this would be that it is designed in such a way as to be acceptable to most of the debtors and creditors concerned.

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## ENDNOTES

- <sup>1</sup> Often, defaults were protracted, reducing the value of assets (Buchheit et al., 2013; IMF, 2013).
- <sup>2</sup> For an overview of the main proposals for international insolvency procedures, see Berensmann and Herzberg (2009), Rogoff and Zettlemeyer (2002), and Bolton and Skeel (2004).
- <sup>3</sup> The IIF has published terms for private sector participation in the DSSI (IIF, 2020b, 2020c and 202d)
- <sup>4</sup> The IFIs' debt governance framework includes two types of instruments. First, joint IMF and World Bank (WB) instruments for the analysis and monitoring of a country's external and internal debt burden such as the Debt Sustainability Analysis, the DSF, the Debt Management Facility or the Public Expenditure and Financial Accountability assessment. Second, the IFIs use policy instruments for implementing debt ceilings on a country's debt such as the IMF's Debt Limits Policy and the International Development Association (IDA's) Sustainable Development Finance Policy (Berensmann, 2017; IMF, 2020b).
- <sup>5</sup> Other instruments and economic policies contributing debt crises prevention comprise fiscal consolidation, improvement of institutions related to the economy on the part of debtors, the development of local-currency bond markets etc. However, these instruments are beyond the scope of this paper.
- <sup>6</sup> Representatives of industrialized countries rejected the SDRM because they preferred market and voluntary approaches. Developing countries and emerging markets were not in favor of this approach because they feared that their countries could lose access to the international capital markets when the procedure is initiated (Filho, 2003; Snow, 2003).
- <sup>7</sup> To further strengthen enhanced CACs and to additionally address collective action problems enhanced CACs could include trust structures. These could improve creditor coordination and address holdout creditors because they limit the possibilities of individual creditors of enforcing that their claims and proceeds are distributed on a pro rata basis.
- <sup>8</sup> In the same vein, majority restructuring clauses for payment terms could be developed for syndicated loans. For restructuring syndicated loans, all members need to agree. Since bank lenders sometimes sell their share of the loan or hand over their interest in a loan to a secondary buyer, it is complicated to achieve unanimous agreement among members. For this reason, exit consents are used to achieve participation in debt restructuring. However, market participants have had the concern that these clauses might not be effective because a large number of sovereign loans are not syndicated loans but bilateral loans. In addition, the private sector might not agree to these clauses because the voting power would be constrained. Nevertheless, majority restructuring clauses for syndicated loans would add to facilitating sovereign debt restructuring. In addition, these majority clauses would represent an alternative to the current use of exit consents (IMF, 2020c, pp. 32–33 and pp. 38–39).
- <sup>9</sup> A further instrument to address holdout behaviors of creditors are exit consents. With a simple majority and the debtor's consent, the contractual terms of an old issue can be amended to reduce the attractiveness of original bond issues for creditors compared to the new bonds offered in the course of the exchange. Examples for amendments are: (i) limiting bond liquidity by no longer listing old issues for trade on the stock market; (ii) cancelling of financial clauses, such as cross default clauses; and (iii) endorsing redemption-free periods. Although amending the terms of old bond issues can lower their value in secondary markets, exit consents make it more difficult for bondholders to enforce their claims, incentivizing creditors to take part in the debt conversion (Berensmann, 2003; Buchheit & Gulati, 2000). Ecuador applied exit consents during the debt restructurings in 2000 (IMF, 2001, 2020c, p. 26)
- <sup>10</sup> The IIF and the emerging economies participating had already agreed on these principles in 2004, while the G20 had endorsed them at the Ministerial Meeting in Germany in 2004.
- <sup>11</sup> In 2003, the Banque de France put forward a code of conduct (the so-called Trichet proposal) that incorporated the following guidelines for the conduct of all market actors – creditors, debtors, and the public sector – before,

and throughout, a debt crisis, including: a timely dialogue between creditors and debtors, a fair exchange of information among all parties involved, speedy and cooperative negotiations, equal treatment of all creditors, and continued adherence to the terms of existing contracts (Banque de France, 2003; Couillault & Weber, 2003).

- <sup>12</sup>The Fund's arrears policy should support members to deal with their balance of payments problems "without resorting to measures destructive to national and international prosperity" (see Article 1 (v) of the Articles of Agreement IMF 2015a, p. 6). In addition, the IMF arrears policy aims at putting in place adequate safeguards for the temporary Fund financing by constraining the members' ability to use additional external financing, that is, accumulation of external arrears (see Article V, Section 3 of the Articles of Agreement IMF, 2015a, p. 6).
- <sup>13</sup>While in the past most of the official claims were ascribed to Paris Club members who committed to Paris Club conventions, that is, comparability of treatment of all creditors, the composition of official lending has changed in the past decade because non-Paris Club members have significantly increased their lending to developing countries (IMF, 2013, pp. 33–34). For example, China held about 25% of the external debt of LICs and middle-income countries in 2020 (World Bank 2021, p. 10). China is the largest creditor for LICs, which are IDA eligible countries and/or belong to the UN list of least-developed countries. Among the G20 countries, China's credit share to these LICs increased from 45% in 2013 to 63% at the end of 2019 (World Bank, 2020, pp. 16–17).
- <sup>14</sup>The OECD Guidelines only include transparency as an explicit principle. For this reason, the focus in this section is put on the other codes of conduct under review.
- <sup>15</sup>In addition, one principle, namely "sovereign immunity," is only included in the proposal of the UN General Assembly (UN General Assembly, 2015).
- <sup>16</sup>Since the OECD Guidelines explicitly incorporate only "transparency" as one principle, they are not discussed in this section. One exception to this is that the OECD also comprises measures to increase "transparency," that is, the OECD informs the IMF and the WB on an annual basis on all transactions to LICs (OECD, 2016, p. 4). The elements related to the institutional setting of the OECD Guidelines have already been included in the previous section (Table 1).
- <sup>17</sup>The Banque de France (2003, pp. 13–14) and Couillault and Weber (2003, p. 160) have also proposed including all stakeholders concerned in the drafting process.
- <sup>18</sup>Gelpern (2013, p. 351) has proposed these steps for UNCTAD's "Principles on Promoting Responsible Sovereign Lending and Borrowing" (UNCTAD, 2012).

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## APPENDIX

### Box 5: IIF Principles for stable capital flows and debt restructuring

#### 1. “Transparency and timely flow of information

- **General disclosure practice:** Issuers should ensure through disclosure of relevant information that creditors are in a position to make informed assessments of their economic and financial situation, including overall levels of indebtedness.
- **Specific disclosure practice:** In the context of a restructuring, the debtor should disclose to all affected creditors maturity and interest rate structures of all external financial sovereign obligations, including the proposed treatment of such obligations; and the central aspects, including assumptions, of its economic policies and programs.

## 2. Debtor-creditor dialogue and cooperation aimed at avoiding restructuring

- **Regular dialogue:** Debtors and creditors should engage in a regular dialogue regarding information and data on key economic and financial policies and performance.
- **Best practices for investor relations:** Communication techniques should include creating an investor relations office with a qualified core staff.
- **Policy action and feedback:** Borrowing countries should implement economic and financial policies, including structural measures, so as to ensure macroeconomic stability, promote sustainable economic growth, and thereby bolster market confidence.
- **Consultations:** Building on IRPs, debtors should consult with creditors to explore alternative market-based approaches to address debt-service problems before default occurs. The goal of such consultations is to avoid misunderstanding about policy directions, build market confidence on the strength of policy measures, and support continuous market access.
- **Creditor support of debtor reform efforts:** As efforts to consult with investors and to upgrade policies take hold, the creditor community should consider, to the extent consistent with their business objectives and legal obligations, appropriate requests for the voluntary, temporary maintenance of trade and inter-bank advances, and/or the rollover of short-term maturities on public and private sector obligations, if necessary to support a borrowing country's efforts to avoid a broad debt restructuring.

## 3. Good faith actions

- **Voluntary, good faith process:** When a restructuring becomes inevitable, debtors and creditors should engage in a restructuring process that is voluntary and based on good faith. Such a process is based on sound policies that seek to establish conditions for renewed market access on a timely basis, viable macroeconomic growth, and balance of payments sustainability in the medium term. Debtors and creditors agree that timely good faith negotiations are the preferred course of action toward these goals, potentially limiting litigation risk. They should cooperate in order to identify the best means for, placing the country on a sustainable balance of payments path, while also preserving and protecting asset values during the restructuring process.
- **Sanctity of contracts:** Subject to their voluntary amendment, contractual rights must remain fully enforceable to ensure the integrity of the negotiating and restructuring process.
- **Creditor committee policies and practices:** If a creditor committee is formed, it should adopt rules and practices, including appropriate mechanisms to protect material non-public information; coordinate across affected instruments and with other affected creditor classes with a view to form a single committee; be a forum for the debtor to present its economic program and financing proposals; collect and analyze economic data; gather, evaluate, and disseminate creditor input on financing proposals; and generally act as a communication link between the debtor and the creditor community.
- **Debtor and creditor actions during restructuring:** Debtors should resume, to the extent feasible, partial debt service as a sign of good faith and resume full payment of principal and interest as conditions allow.

## 4. Fair treatment

- **Avoiding unfair discrimination among affected creditors:** The borrowing country should avoid unfair discrimination among affected creditors. This includes seeking rescheduling from all official bilateral creditors. In line with general practice, such

credits as short-term trade related facilities and interbank advances should be excluded from the restructuring agreement and treated separately if needed.

- **Fairness of voting:** Bonds, loans, and other financial instruments owned or controlled by the sovereign should not influence the outcome of a vote among creditors on a restructuring.”

*Source:* Summary of the IIF principles, for a more detailed description of this proposal, see IIF 2021, pp. 55–57

### Box 6: UN (2015), Debt Workout Principles

“Improved debt workout practices would result from adherence to a set of commonly shared principles. Such principles would provide an orientation for stakeholders when negotiating debt workouts or when adjudicating cases related to sovereign debt workouts. They translate into more specific recommendations for each step of a sovereign debt workout, set out below and in more detail in the Guide. The principles include:

**Legitimacy** requires that the establishment, operation, and outcomes of mechanisms and procedures for sovereign debt workouts observe the requirements of ownership, comprehensiveness, inclusiveness, predictability, and other aspects of the rule of law.

**Impartiality** requires that actors, institutions, and information involved in debt workouts are free from bias and undue influence. While it is natural for creditors and debtors to pursue their self-interest, debt workouts require a neutral perspective, particularly with regard to sustainability assessments and decisions about restructuring terms.

**Transparency** requires that information on debt workout institutions, processes, and the underlying data is available to the public.

**Good Faith** requires that debt workout procedures and their legal and economic outcomes meet basic expectations of fairness.

**Sustainability** requires that sovereign debt workouts are completed in a timely and efficient manner and lead to a stable debt situation while minimizing costs for economic and social rights and development in the debtor state.”

*Source:* UNCTAD 2015, p. 4

### **Box 7: UN General Assembly (2015), Principles on Sovereign Debt Restructuring**

“1. A Sovereign State has the right, in the exercise of its discretion, to design its macroeconomic policy, including restructuring its sovereign debt, which should not be frustrated or impeded by any abusive measures. Restructuring should be done as the last resort and preserving at the outset creditors’ rights.

2. Good faith by both the sovereign debtor and all its creditors would entail their engagement in constructive sovereign debt restructuring workout negotiations and other stages of the process with the aim of a prompt and durable re-establishment of debt sustainability and debt servicing, as well as achieving the support of a critical mass of creditors through a constructive dialogue regarding the restructuring terms.

3. Transparency should be promoted in order to enhance the accountability of the actors concerned, which can be achieved through the timely sharing of both data and processes related to sovereign debt workouts.

4. Impartiality requires that all institutions and actors involved in sovereign debt restructuring workouts, including at the regional level, in accordance with their respective mandates, enjoy independence and refrain from exercising any undue influence over the process and other stakeholders or engaging in actions that would give rise to conflicts of interest or corruption or both.

5. Equitable treatment imposes on States the duty to refrain from arbitrarily discriminating among creditors, unless a different treatment is justified under the law, is reasonable, and is correlated to the characteristics of the credit, guaranteeing inter-creditor equality, discussed among all creditors. Creditors have the right to receive the same proportionate treatment in accordance with their credit and its characteristics. No creditors or creditor groups should be excluded *ex ante* from the sovereign debt restructuring process.

6. Sovereign immunity from jurisdiction and execution regarding sovereign debt restructurings is a right of States before foreign domestic courts and exceptions should be restrictively interpreted.

7. Legitimacy entails that the establishment of institutions and the operations related to sovereign debt restructuring workouts respect requirements of inclusiveness and the rule of law, at all levels. The terms and conditions of the original contracts should remain valid until such time as they are modified by a restructuring agreement.

8. Sustainability implies that sovereign debt restructuring workouts are completed in a timely and efficient manner and lead to a stable debt situation in the debtor State, preserving at the outset creditors’ rights while promoting sustained and inclusive economic growth and sustainable development, minimizing economic and social costs, warranting the stability of the international financial system and respecting human rights.

9. Majority restructuring implies that sovereign debt restructuring agreements that are approved by a qualified majority of the creditors of a State are not to be affected, jeopardized or otherwise impeded by other States or a non-representative minority of creditors, who must respect the decisions adopted by the majority of the creditors. States should be encouraged to include collective action clauses in their sovereign debt to be issued;

Invites all Member and observer States, competent international organizations, entities and other relevant stakeholders to support and promote the Basic Principles set out above,

and requests the Secretary-General to make all efforts so that the Principles become generally known;

Decides to continue to consider improved approaches to restructuring sovereign debt, taking into account the Basic Principles set out above and work carried out by the international financial institutions, in accordance with their respective mandates, and to this effect decides further to define the modalities for such consideration.”

*Source:* UN General Assembly 2015

### **Box 8: Recommendation of the Council on Sustainable Lending Practices and Officially Supported Export Credits**

“On the proposal of the Working Party on Export Credits and Credit Guarantees:

- II. Recommends that, when deciding to provide official export credits with a repayment term of one year or more to public obligors or publicly guaranteed obligors in lower income countries, Members and non-Members having adhered to this Recommendation (hereafter the “Adherents”):
- (a) take into account the results of the most recent IMF/World Bank country specific debt sustainability analyses (DSAs) conducted within the joint DSF, and review the relevant program or policy documents in relation to each transaction under consideration for support. The IMF’s debt limits for specific countries are included in the program documents, and the Memorandum of Understanding in those documents sometimes also include reference to specific projects for which non-concessional borrowing is allowed.
  - (b) take into account the prevailing limits on public sector non-concessional borrowing, according to the methodology applied by the World Bank and the International Monetary Fund, for a specific country for transactions involving public obligors or publicly guaranteed obligors in lower-income countries that are subject to debt limit conditionality for non-concessional borrowing under the IMF’s Debt Limits Policy (DLP) or the World Bank’s Non-Concessional Borrowing Policy (NCBP). To that effect, Adherents should
    - (i) not provide support for official export credit transactions involving public obligors or publicly-guaranteed obligors in lower income countries that are subject to a zero limit on non-concessional borrowing under the DLP or the NCBP (recognizing that, in rare circumstances, countries may be moved from a zero to a non-zero limit under IMF and World Bank policies following consultations between country authorities and IMF or World Bank staff, as well as subsequent management/board approvals from the respective institutions);

- (ii) seek assurances, on a best effort basis, from the appropriate government authorities in the debtor country that the project/expenditure is in accordance with the DLP or the NCBP for that country for official export credit transactions involving public obligors or publicly-guaranteed obligors in lower-income countries that are subject to a non-zero limit on non-concessional borrowing under the DLP or the NCBP with a credit value in excess of SDR 5 million (for very small countries with low national income levels of less than USD 1 billion, a threshold of SDR 1 million should be applied). In this regard, participation of the Ministry of Finance or central bank in a transaction as the obligor or guarantor would be sufficient evidence of this obligation having been met.
  - (c) so that the IMF and World Bank are aware of all potential public external debt obligations related to projects in lower-income countries to be supported by official export credits in countries before they are contracted, inform the IMF and World Bank via the “Lending to LICs” mailbox, as soon as possible and in any event before the decision to provide support is finalized, of their intention to provide support for any official export credit transaction involving a public obligor or guarantor in a lower-income country that is subject to debt limits conditionality for non-concessional borrowing under the DLP or NCBP with a credit value in excess of SDR 5 million (for very small countries with low national income levels (less than USD 1 billion), a threshold of SDR 1 million should be applied), providing the level of detail necessary in order for the project to be identified and for the basic financial terms and conditions to be known.
- III. Recommends that Adherents provide data via the OECD Secretariat to the IMF and World Bank on all supported transactions to lower-income countries on an annual basis in order to, inter alia, assess Adherents’ success towards ensuring that official export credits to lower income countries are not provided for unproductive purposes and are consistent with the aims of the DSF for these countries.
  - IV. Invites the Adherents and the Secretary-General to disseminate this Recommendation.
  - V. Invites non-Adherents to take due account of and to adhere to this Recommendation.
  - VI. Instructs the Working Party on Export Credits and Credit Guarantees to monitor the implementation of this Recommendation and to report thereon to Council no later than five years following its adoption and regularly thereafter.”

*Source:* OECD 2018



### **Box 9: G20 Operational Guidelines for Sustainable Financing**

“The Addis Ababa Action Agenda on Financing for Development recognizes that borrowing is an important tool for financing investment critical to achieving sustainable development, including the sustainable development goals. Sovereign borrowing also allows government finance to play a countercyclical role over economic cycles. However, borrowing needs to be managed prudently”. In this regard, UN member states “reiterate[d] that debtors and creditors must work together to prevent and resolve unsustainable debt situations”, that “maintaining sustainable debt levels is the responsibility of the borrowing countries; however [...] acknowledge[d] that lenders also have a responsibility to lend in a way that does not undermine a country’s debt sustainability”, and agreed to “work towards a global consensus on guidelines for debtor and creditor responsibilities in borrowing by and lending to sovereigns, building on existing initiatives.”

Against this backdrop, G20 countries endorse and will promote the following operational guidelines, taking into account national circumstances. The aim of these guidelines is to enhance access to sound financing for development while ensuring that sovereign debt remains on a sustainable path by fostering information-sharing and cooperation among borrowers, creditors and international financial institutions, as well as learning through capacity building.

These operational guidelines are classified into five dimensions: adequacy, transparency, consistency, coordination, and resilience.

#### **1. Adequate financing for sustainable development**

- Exploration of options to provide adequate financing for developing countries. Sovereign debtors and creditors will work together to strike a right balance between meeting financial needs for investment and sustainable development and maintaining debt sustainability. They will continue to explore various financing options to help developing countries access long-term financing and bolstering potential growth, while preserving sustainable debt levels.

#### **2. Information-sharing and transparency**

- Promotion of transparency regarding macroeconomic indicators and debt sustainability assessments. Sovereign creditors and debtors should build a common understanding of the macroeconomic and financial situation of the borrower country, based on the most recent estimates of the international financial institutions (IFIs), including the latest Debt Sustainability Analysis (DSA). In this regard, G20 countries will enhance information sharing with respect to debt sustainability, including signaling to IFIs’ staff if large public liabilities appear not to have been included in the DSA of a debtor country. Moreover, they encourage borrowing countries to continue to enhance fiscal transparency and public debt management, as well as to provide the IMF, and other IFIs as appropriate, information on their debt and indirect liabilities (e.g., as guarantors of public entities).

- Promotion of transparency regarding relevant cases of past sovereign debt restructurings. As a general policy, information on past debt restructurings from official and private creditors should be made public, as appropriate.

### **3. Consistency of financial support**

- Consistency of borrowing and lending practices with debt limits policies as a shared responsibility of debtors and creditors. As emphasized in the Addis Ababa Action Agenda, borrowing countries and lenders, including sovereign lenders, share responsibilities in maintaining debt on a sustainable path. G20 countries recognize the applicable requirements of the IMF's Debt Limits Policy (DLP) and of the International Development Association's Non-Concessional Borrowing Policy (NCBP), and commit, as shareholders of those institutions, to improving the transparency in providing financing to debtor countries and working closely with the IFIs to help debtor countries meet those debt sustainability requirements. In order to achieve that, IFIs need to have early consultation with and if necessary alert creditors on borrowing countries' debt levels to avoid any potential inconsistency. Debt ceilings and most recently reported borrowing levels are being collected in one table which is public and regularly updated by the IFIs, helping in providing information to all lenders and borrowers about possible opportunities and constraints.
- Committing to the long-term debt sustainability of borrowing countries, notably by aiming at ensuring that commercial creditors adequately contribute to debt relief when required, and by ensuring that official creditors deliver on their own commitments. When unavoidable, debt restructuring should be conducted in good faith in a timely, orderly, and effective manner, facilitating appropriate burden-sharing.
- Provision of the necessary technical assistance to debtor countries, directly or through the international institutions in order to enhance their debt management capacities, while ensuring recipient countries take ownership over building their debt management capacities. This specifically covers the ability to staff and train debt management offices, and to ensure their familiarity with the different forms of sovereign borrowing, as well as the costs and opportunities attached to them. G20 countries support the Debt Management Facility (DMF) of the IMF and the World Bank and the Debt Management and Financial Analysis System (DMFAS) program of the United Nations Conference on Trade and Development (UNCTAD), and the ongoing work aimed at strengthening the DSF (DSF) of the IMF and the World Bank as a shared reference by all potential lenders in their dealings with a borrower.

### **4. Coordination of stakeholders**

- Ensuring a regular dialogue between sovereign creditors, debtors, and international financial institutions. Interaction on a regular basis between these stakeholders, and not only at times of distress, is the most efficient way of fostering trust among sovereign actors. This will consequently make it easier for crises to be identified and anticipated, and for their resolution to be implemented. The IMF, the Paris Forum and Paris Club meetings, and UNCTAD are examples of venues where such a dialogue can take place.
- Ensuring coordinated policies between international financial institutions. Interaction and policy coordination on a regular basis between the IMF, the World Bank, the regional development banks, and other financial and development institutions will promote more efficient development, budgetary, and other loan policies and ensure a consistent approach for safeguarding financial sustainability.

### **5. Promotion of contractual and new financial instruments and minimizing litigation issues to strengthen resilience**

- Continue to work on and consider usage of new financial instruments, when relevant, that embed more resilience into the debt structure of the recipient country, for instance

GDP-indexed contracts, debt instruments with extendible maturities, and natural disaster mechanisms, targeted to limit patterns of repeated over-indebtedness in the most vulnerable countries. G20 countries encourage the development of local currency bond markets as a way of improving the resilience of the domestic economy and financial system.

- Promotion of enhanced contractual clauses most often found in foreign-law sovereign bond issuances (modified pari passu and enhanced collective action clauses – CACs). International sovereign bonds are an increasingly prevalent form of external indebtedness for countries. G20 countries commit to continue promoting the standards best suited to avoid protracted negotiations with minority holders.

- Address the challenges posed by some litigating creditors. Aggressive litigation by non-cooperative minority creditors poses challenges in the financing and debt restructuring processes, especially for the poorest countries that lack the technical capacity to face such a legal challenge. G20 countries commit to explore enhanced international monitoring of litigation by non-cooperative minority creditors and take action as appropriate."

*Source:* G20, 2017