CLIFFORD

CHANCE

SOVEREIGN DEBT RESTRUCTURING

PROPOSED AMENDMENT TO NEW YORK BANKING LAW THROUGH NEW ARTICLE 7

Overview

Against the backdrop of the COVID-19 pandemic and its severe economic consequences certain New York lawmakers have introduced draft legislation designed to allow unsustainable sovereign and subnational debt to be restructured through new procedures to be built into the existing New York banking law by way of a new Article 7.

This is notwithstanding that the G20 has in 2020 and 2021 fronted a major initiative in respect of the world's poorest countries by way of its debt service suspension initiative ('DSSI') which, in broad terms, suspends debt service for requesting eligible countries to permit resources to be directed towards healthcare and social safety net spending arising from the pandemic, and agreed a Common Framework which it and the Paris Club envisage applying to those countries which require debt relief beyond the suspensions made available under the DSSI as described in the G20 communiqué dated 13 November 2020.

Some proponents of the proposed New York legislation argue it is needed to address further continuing holdout creditor problems, although the recent cases of Ecuador and Argentina (and a number of its Provinces) have shown that with good creditor engagement, the current contract based architecture for restructuring sovereign debt is effective in delivering an orderly outcome in a timely manner. Other proponents of the proposed New York legislation, are of the view that the current system for restructuring sovereign debt is inadequate, leading to prolonged negotiations in respect of numerous debt financings, delays, destabilizing and speculative behaviour by some investors and unacceptable human cost and that consequently the State of New York, absent a Federal treaty, has the right and responsibility to step in and seize what is perceived as a financially powerful opportunity.

Even though the proposed New York legislation would retroactively impair contract rights, the proponents of the proposed law believe that any such impairment would be a reasonable exercise of New York State's police powers to protect its economy by reducing the likelihood that a country-debt default could trigger a systemic collapse.

As there is no applicable insolvency or bankruptcy regime for sovereign debtors this proposal is notable. A sovereign debt restructuring mechanism ('SDRM') was proposed in November 2001 by the then Managing Director of the International Monetary Fund ('IMF') but was eventually shelved. Market initiatives, including the use of collective action clauses ('CACs') in sovereign bond issuances governed by New York law, were adopted in the wake of the SDRM proposal. The IMF, which has roles in relation to its member states under its Articles of Agreement by way of surveillance (Article IV), financial assistance, or more colloquially as lender of last resort, (Article V, section 3) and technical assistance (Article V, section 2(b)) has, not surprisingly, been involved in promoting much activity in this field. Such initiatives, including to address perceived holdout creditor problems have been, and continue to be, further refined over time and it is now routine for new sovereign bond issuances governed by New York or English law to contain the latest enhanced CACs published by the International Capital Market Association ("ICMA") in 2014/2015 together with a template *pari passu* clause disavowing the rateable payment interpretation of *pari passu* clauses at the heart of the Argentine litigation prior to the latest Argentina restructuring. Enhanced CACs in broad terms allow voting across various sovereign bond issuances to be aggregated in a manner with parallels to that used in US Chapter 11 corporate bankruptcy with the ability to conduct a single aggregated vote at the 75% level. If the voting threshold is reached, those bondholders which do not vote or vote against the proposal put to them are bound by the outcome of the votes and so would be crammed down, again in a manner similar to that available in US Chapter 11 proceedings. The vast majority of sovereign bonds are now issued with these enhanced CACs.

That said, it is generally accepted that there is a significant volume of sovereign debt without majority amendment provisions for payment terms. This is because some types of sovereign debt, including loans, do not generally contain majority voting for payment term revisions and because there are outstanding sovereign bonds which were issued before the adoption of the enhanced CACs with long original maturities (although most of these legacy bonds contain single series CACs, so within an individual series of bonds the minority can be crammed down if the majority votes in favour of a restructuring proposal). With this in mind, the IMF and other market stakeholders are, for example, taking a renewed interest in how sovereign loans are restructured, when necessary, following a number of years where sovereign bonds were at the centre of market innovations to facilitate sovereign debt restructurings (see IMF Staff Paper of October 1, 2021 – The International Architecture for Resolving Sovereign Debt Involving Private – Sector Creditors – Recent Developments, Challenges and Reform Options). Overall therefore, current thinking on how to facilitate sovereign debt restructuring further has focused on incremental contractual enhancements, greater debt transparency, increasing private sector participation when debt relief is needed and earlier creditor engagement among other things. For the most part, a new SDRM or major international initiative in respect of a sovereign debt restructuring treaty or model law has not been favoured at this time. Hence the proposed New York law approach is unexpected and the lack of consultation thereon has raised concerns.

Significant volumes of sovereign debt are governed by New York law and the proposed legislation is therefore significant as it could impact on an important segment of the sovereign debt market in a way which those contracting under New York law would not have foreseen or expected. In seeking to address any concerns associated with sovereign debt, it is very unusual to seek to legislate. France took that route in 2016 through legislation designed to prevent asset seizures by creditors who purchased sovereign debt if certain conditions are satisfied. In 2015 Belgium passed legislation to prevent creditors from suing for more than they paid for the debt in certain circumstances. These measures have not had significant impact in the markets because their reach is primarily domestic. The UK passed the Debt Relief (Developing Countries) Act in 2010, to assist in the implementation of heavily indebted poor country ('HIPC') debt relief. English law, like New York law, is widely used in the sovereign debt markets, and the UK legislation was specific only to HIPCs and was initially implemented for one year only to allow an assessment to be made as to any unwelcome unforeseen consequences before it was made permanent. The approach taken through the draft of new Article 7 is far more broad ranging than the UK, Belgian and French legislation, both in scope and application.

It has become customary for there to be market consultations with varying degrees of formality in respect of proposed significant initiatives in the field of sovereign debt restructurings. A consultation process allows both a technical review and the evaluation of potential unintended consequences to be undertaken, for example, any pricing implications for new debt raisings following a new policy initiative, potentially affecting the debt sustainability of debtor countries through increased debt servicing costs or leading to loss of market access quicker than might otherwise have been the case. Rating implications and the risk of accelerated sell offs have also been taken into consideration in developing policy in this area.

Many developing countries currently face a fragile economic environment with resources redirected to health care spending and social safety nets and many will require additional financing in particular to meet sustainable development goal aspirations. A consultation process associated with the proposed new Article 7 would, most likely, highlight potential risks associated with loss of market access and pricing and feed into legitimate re-evaluations of structure, concepts and more detailed aspects. One concern with the proposed legislation is that it leaves out important details, creating uncertainty and unpredictability for all stakeholders. Moreover such uncertainty and the need therefore to complement the regime in due course could lead to longer drawn out restructuring processes fraught with potential challenges.

The full draft of Article 7 is set out in the Annex and it is reviewed section by section below. Points of note are highlighted as they arise. By way of executive summary, a country facing financial difficulties which believes it has unsustainable debts can file a petition with a new independent body nominated by the New York State Finance Committee. Article 7 describes the required process, certifications and notifications to creditors. It contemplates an extensive audit process and that a plan for restructuring will be submitted by the country which designates different classes of claims. Majority voting applies to each class and so, effectively, majority payment term amendment is retroactively introduced into debt contracts. Once a plan is approved by all classes, the plan becomes effective at which point contractual rights to payment are effectively replaced by those specified in the plan. New Money may be raised through majority voting and is legally senior to other claims. Where Article 7 is involved, the effect is to retroactively alter existing New York law contractual rights including any enhanced CACs that may be included in any sovereign bonds governed by New York law.

1. Introduction and Stated Purpose

1.1 Observations, unless otherwise stated, are confined to the text of the proposed new Article 7 (annexed). This new draft Article contains Sections 300 to 309 inclusive.

1.2 The stated purpose is to 'provide effective mechanisms for restructuring unsustainable sovereign and subnational debt' (section 300).

Note here that:

- the concept of debt being 'unsustainable' in the context of sovereign debt restructurings is usually determined by the IMF through its debt sustainability analysis ('DSA'). Whilst not without question by private creditors on occasions, the work of the IMF on DSAs is a generally accepted significant anchor to sovereign debt restructurings and evaluations as to the resulting amount of debt relief which may be sought.
- please see paragraph 3.4 below for a description of 'unsustainable'.
- subnational debt is not clearly defined and so could give rise to ambiguity.

1.3 The new Article 7 is brief and written in simple terms. Whilst this approach could be regarded as a virtue, there are many areas of important detail which are not covered and the main operative provisions do not appear to be designed to dovetail with the existing sovereign debt restructuring architecture (the 'Existing Architecture') under which the IMF and the Paris Club have key roles.

2. What Debts Can be Restructured under Article 7

2.1 Key concepts are:

2.1.1 'claim' which in broad terms is borrowed money or a state's guarantee (or equivalent) for borrowed money.

Note here that: debts with an original maturity of less than one year and trade debt through letters of credit are typically excluded from debt restructurings under the Existing Architecture. Whilst there is one exclusion for trade accounts arising in the ordinary course of business (which would generally not be borrowed money in any event), there are no exclusions in Article 7 for debts with an original maturity of less than one year or trade debt through letters of credit. Accordingly, the impact on those types of financings would be likely to be considerable, which itself would be likely to have adverse unwelcome consequences for sovereign and sub sovereign borrowers.

Other distinctions generally made in connection with claims in the Existing Architecture are not utilised. These extend to domestic vs external debt; secured vs unsecured debt. There would therefore be likely to be consequences in the market for sovereign finance, for example, finance to purchase or construct a building where the lender would have the benefit of security over the building; or equipment supplied on credit title retention terms where title passes once the final payment is made, would be likely to be impeded. Similarly, there is no provision for set offs and other similar issues which arise in the administration of a typical bankruptcy process (e.g. a hotchpot rule to limit recoveries under Article 7 for creditors gaining outside of Article 7).

2.1.2 'creditor' which is a person or entity to whom a claim is owed by a state.

2.1.3 'state' is a sovereign nation or unincorporated territory or any subnational unit thereof (but excluding any municipality whose adjustment or debts is governed by 11 U.S.C. 9). In practice, whilst the sovereign nation element is clear, this definition is likely to give rise to ambiguity in relation to the other two elements.

2.2 Section 301 is used to provide other defined terms for the purposes of new Article 7 which include:

2.2.1 'comprehensive audit' – this is a broad term which describes a process which considers the contracting, refinancing or negotiation of public debt targeted at determining the 'lawfulness, transparency, quality, efficacy, efficiency and sustainability thereof'.

2.2.2 'plan' is the state's restructuring plan around which Article 7 is framed.

2.2.3 'supervisory authority' is an independent body referred by the New York state senate finance committee.

Note here that:

- the concept of comprehensive audit goes beyond the norms employed under the Existing Architecture. This then is further discussed in paragraph 5 below.
- the supervisory authority has a key role and so its appointment will be of considerable significance to active participants in any Article 7 process. It is unclear what powers or discretions to make judgements are intended for the supervisory authority or which types of independent bodies would be in the frame for and might accept such a role, which may involve elements of legal risk and liability. It is unknown whether a standing body is contemplated.

3. **Initiation of the Process**

3.1 Section 302 sets out the process through which claims of a sovereign may be restructured. It contains both procedural and substantive features.

3.2 The main procedural features include:

– a state filing a petition for relief with the supervisory authority.

– a petition must contain specified certifications from the state.

3.3 The substantive features are effectively woven into the certifications required as part of the petition and also set out in Section 303.

3.4 The petition must contain five certifications (set out in Section 302.2(a) to (e) inclusive). These are (in order):

- relief is sought by the state under Article 7 and the state has not sought relief under Article 7 or any equivalent law within the last 10 years.
- the state needs relief to restructure claims that would otherwise be unsustainable.
- ***Note here that****:* whilst 'unsustainable' is undefined, Section 302.2 contemplates that the applicable state will self-certify that it needs to restructure claims. This is at variance with the Existing Architecture under which the IMF conducts a DSA. Assuming that the state has an IMF Programme (which often contains structural adjustment measures from the state designed materially to reduce the prospects of further debt relief being required), the Paris Club, to the extent it is involved, then generally applies the DSA to the debt relief it offers to the state and includes a comparability of treatment provision in respect of non-Paris Club claims. Even if the Paris Club is not involved in most cases the IMF will be and will conduct a DSA which underpins the scope and amount of debt relief being sought. Creditors and other stakeholders are likely to be uncomfortable with self-certification of unsustainability.
- the state agrees to restructure those claims in accordance with Article 7.
- the state agrees to all other terms, conditions and provisions in Article 7.
- any local law steps required in order give effect to its certifications have been taken.

3.5 Section 302.3 provides that immediately after the filing of such a petition (as long as it has not been dismissed by the supervisory authority) the terms, conditions and provisions of Article 7 shall (a) apply to any New York law governed claim; (b) apply to any claim governed by the law of another jurisdiction which has enacted a substantially similar law to Article 7 and (c) be recognised in all jurisdictions that have enacted Article 7 or its equivalent.

Note here that*:*

- operationally, the timing associated with 'immediately' does not fit well with other timing related matters.
- the ability of the supervisory authority to dismiss a petition is not elaborated other than a reference to a lack of good faith. There is no definition of "good faith" in Article 7.
- the governing law limitation is material and those promoting the new Article may assume that other jurisdictions will implement substantially similar laws. It is unclear how this could work, in that, as drafted, any other such similar law would itself require the filing of a petition by the state in that other jurisdiction thereby creating a parallel regime, unless it is the legislative basis for the filing of a petition with the supervisory authority under Article 7 which is envisaged, raising significant evaluations of sovereignty for any jurisdiction contemplating such a step.

- the effect, described in paragraph 6 below, is to introduce pooling of claims and majority voting concepts into contractual provisions governing those claims. Further, as described in paragraph 7 below, new money which is legally senior to the existing claims, may arise. At its core the effect of Article 7 is therefore to vary existing contractual rights. It would also appear to be seeking to do so in circumstances which would ordinarily be affected by foreign relations considerations and so naturally fall under the aegis of the federal government. The US Constitution protects contract rights (e.g. a taking of private property may be an expropriation which requires just compensation). It also limits the ability of US states to pass laws which impair contractual rights. In very broad terms, historically, the US National Government position, where the debts owed by foreign sovereigns are unsustainable, has been to promote voluntary creditor participation through negotiation. Article 7 therefore strays into areas which may be regarded as beyond normal limits and, as a result, may raise separation of powers arguments by affected stakeholders.
- the reference to 'jurisdictions' does not fit well with arrangements expressly or impliedly governed by international law, which governs many arrangements between international treaty institutions and their member states.
- the filing of a petition is likely to (a) be regarded as a negative event by rating agencies and (b) give rise to events of default or potential events of default in many types of debt arrangements.

4. **Notification to, and list of, creditors**

4.1 Section 303 requires the state to notify all known creditors with 30 days of the filing of a petition.

4.2 The supervisory authority is required to prepare and maintain a current list of creditors and verify claims for voting purposes under Article 7.

Note here that:

- where there is an active trading market in the applicable claims (e.g. through bonds trading through international clearing and settlement systems) these provisions are likely to be challenging to administer well.
- most sovereign debt restructurings requiring voting from creditors proceed on the basis that trading is effectively frozen whilst the voting process is being conducted through blocking instructions to the clearing and settlement systems. These types of operational aspects are not addressed.
- verification of claims, described more fully in paragraph 5 below, has occurred in some country cases and the terms of reference for those conducting verification is key. The terms of reference implicit in the definition of 'comprehensive audit' are broad and also contain elements which will be subjectively determined. In practice timeframes for verification exercises have been measured in years. That does not sit well with other timing features of Article 7.

5. **Audit Process**

5.1 Section 304 requires 'a comprehensive audit' to be conducted. There is no mention of timing or how that audit is to sit in the sequencing of other events associated with a debt restructuring plan.

5.2 The supervisory authority must choose an independent body to conduct the audit.

5.3 The state bears the cost of the audit.

5.4 The audit is required to abide by the general principles issued by the International Organisation of Supreme Audit Institutions.

Note here that*:*

- the consequences arising from the audit, which we assume to be linked to verification referred to in Section 303, are not described. The result may be ambiguity as to whether any particular claim is still regarded as a claim for the purposes of Article 7 and the consequence for any claim which is not.
- in practice any entity taking on such a role is likely to insist upon extensive exculpatory protection and indemnities. Customary protection from the client (i.e. the state) is unlikely to be sufficient, given creditworthiness associated with initiating Article 7 at the outset. Protection from creditor action within Article 7 itself may therefore be required.
- whilst laudable from a debt transparency perspective, this approach is not standard and would considerably slow the pace of restructuring.
- generally, an audit process would be a domestic consideration for a state carried out in country. The interaction with any country level national audit office is not addressed.
- the process contemplated would raise confidentiality considerations and be entirely dependent on the state providing historic as well as current documentation.
- the output of the audit is unclear; it could take the form of a report or recommendations; is it to be publicly available? In many areas it will inevitably be subjective or indeterminate (requiring considerable legal input in respect of both domestic and foreign laws) and consequences for the debt restructuring plan or the state arising in those contexts are not addressed.
- we are not in a position to determine suitability of the general principles for the audit for all entities comprised with the term 'state'.

6. **The Debt Restructuring Plan from the State**

6.1 Section 305.1 provides that a state may both submit a plan and submit alternative plans from time to time. On its face this construction appears to undermine the 'only once in each ten years' requirement mentioned in paragraph 3.4 above.

6.2 Section 305.2 makes clear that only the state may submit a plan and that cannot be done by any other party on behalf of the state.

6.3 A plan is required to designate classes of claims on the basis that each class of claims is comprised of claims against the state that are equal in priority. However, all equal claims need not be in the same class; claims of 'governmental or multi-governmental entities' must be classed separately and claims governed by Article 7 or its equivalent under the laws of other jurisdictions may not be classed with other claims. (Section 305.6)

6.4 A plan must specify the proposed treatment of each class of claims. Each claim of a particular class must have the 'same treatment' unless the holder agrees to inferior treatment. Claims not included in the plan must be disclosed.

6.5 The plan itself must 'provide adequate means' for its implementation including dealing with 'curing or waiving any defaults or changing the maturity dates, principal amount, interest rate, or other terms or cancelling or modifying any liens or encumbrances'. Further, the state must certify that if the plan becomes effective the state's debt will become sustainable.

6.6 Critically a plan will become binding and effective on the state and its creditors when it has been submitted by the state and agreed to by each class of claims of those creditors. Once that has occurred, the state is 'discharged from all claims included in those classes of claims, except as provided in the plan'. In other words, the restructuring terms then apply to the exclusion of the original contractual rights.

6.7 The test for agreement by each class of creditors is that at least two thirds in amount and more than one half in number of the claims of that class which vote agree to the plan (Section 305.5).

Note here that:

- the aggregate voting threshold in Section 305.5 contains no safeguards of the type used in single limb aggregated voting in the enhanced CACs recommended as part of the Existing Architecture, most importantly the uniformly applicable safeguard in the enhanced CACs requires existing holders to be offered the same terms or to select from an identical menu of options and the information covenant also therein requires the country to set out detailed economic and financial information, including a description of its policy reform and provisional macroeconomic outlook no later than any proposal to revise payment terms. These enhanced CACs published by ICMA in May 2015 followed roughly 18 months of intensive work by an expert group convened by US Treasury staff with participation from debtor countries, IMF and Paris Club staff, the investor community, ICMA, legal practitioners and academics. This policy innovation was recognised as a potential market moving event and there was extensive consultation prior to release. These enhanced CACs were then endorsed by the IMF, the IIF and other stakeholders and the IMF has continued to monitor take up levels which have remained very high. The recent sovereign debt restructurings of Argentina and Ecuador were successfully executed using the enhanced CACs (through use of the two limb voting mechanism option) following intense creditor engagement and with no holdouts.

- the same treatment for holders of claims in a class could limit a menu approach unless it is intended to be a reference to net present value which raises complex issues.
- there is no reference to disenfranchising debtor or debtor controlled holders of claims.
- the inclusion of claims owed to multi governmental entities in a class is difficult to reconcile with norms associated with preferred creditor status in the Existing Architecture.
- the plan appears not to include any of the customary conditionality associated with an economic reform programme built into a letter of intent as part of an IMF Programme typically used as part of the Existing Architecture. Similarly, the DSA is not a reference point for the restructuring terms, rather the state's own assessment appears to be the basis for the restructuring terms.
- the process is difficult to reconcile with existing Paris Club norms and processes.
- the inclusion of 'adequate means' in the plan to seek to cure defaults is untimely as steps to avoid defaults should ideally be taken at an earlier stage through requests for consents or waivers.
- the conjunctive requirement in the voting by class under which a majority by number as well as two thirds by value of claims is the threshold is potentially open to abuse. A creditor seeking to undermine the process could sell one dollar, or even one cent claims, to multiple like-minded parties who then all vote against the plan.
- by separating the claims governed by New York law (and jurisdictions which have enacted an equivalent to Article 7) from other claims and requiring that each class designated in the plan has agreed to the plan, Article 7 can only proceed where those other classes (which may lack any form of majority voting) agree. That could hand considerable power and leverage to creditors in other classes.

7. **New Money**

7.1 Section 306 contains provisions which are conceptually similar to debtor in possession financings used in many corporate bankruptcy/insolvency arrangements.

7.2 There are procedural requirements under which the state is required to notify all of its known creditors of its intention to borrow new money. In doing so it is also required to specify the applicable terms and conditions for the proposed new borrowing, the proposed use of the proceeds and to direct those creditors to notify the supervisory authority within 30 days as to whether they approve or disapprove of the proposed new loan.

7.3 If at least two thirds by value of those notifying the supervisory authority within 30 days of their views agree then the proposed new loan is approved. Separately, in order to enjoy priority 'of repayment and corresponding subordination' a vote of 'covered claims' is required. Covered claims appear to be New York law governed claims under the plan or claims governed by the laws of any other jurisdiction which has enacted the equivalent of Article 7. The voting threshold for these purposes is two thirds by value of those responding to the supervisory authority within 30 days.

7.4 Section 307 set out the priority and simply states that such new money loans must be repaid prior to the payment of any other claims. There are no exclusions.

***Note here that**:*

- in practice, the lack of exclusions is likely to be problematic.
- the anticipated arrangements are difficult to reconcile with preferred creditor status for IMF claims and claims of other international financial institutions which regard themselves as benefitting from preferred creditor status, which is generally preserved through the methodology used in the DSA.

8. **Adjudication of Disputes**

8.1 Section 308 provides that a court of competent jurisdiction may appoint a referee or special master to make recommendations to the court regarding the resolution of any disputes arising under Article 7.

8.2 The issue of costs is not addressed.

***Note here that**:*

- this could raise the possibility of competing actions being pursued through whatever dispute resolution mechanism is recommended by the referee or special master and the dispute resolution mechanism in the underlying finance documents, leading to delays and legal uncertainty.

9. **Retroactivity and Opt in Rights**

9.1 Section 309 clarifies that where Article 7 is invoked in accordance with its terms, the effect is retroactively to alter existing New York law governed contractual rights.

9.2 In accordance with many corporate bankruptcy arrangements, creditors with claims against the state may opt into the bankruptcy style procedure used in Article 7. If they do so their claims are effectively treated as though they were governed by New York Law for the purposes of Article 7.

9.3 Article 7 would take effect immediately it has become a law.

***Note here that**:*

- Creditors would therefore not know whether their contracts were in the form entered into or as amended by Article 7 if a state submitted a petition under Article 7. This could have unforeseen market consequences.

10. **Other Observations**

10.1 Article 7 contains no stay on proceedings. Activation of Article 7, through the filing of a petition may result in litigation, even in a pre-payment default scenario, as events of default and potential events of default would be occurring at this point. Litigation on contract claims may therefore occur almost simultaneously with activation.

10.2 It is possible that the promoters of the Bill envisage that sovereign debt restructurings will not necessarily take place under new Article 7 but rather will be encouraged because the parties know that the alternative of Article 7 restructurings exist. In that conception restructurings would be encouraged to occur outside of Article 7 and would be taking place under its shadow.

10.3 Innovations and policy development in the sovereign debt space have to date involved varying degrees of consultation from relevant stakeholders aimed not only at enhancing the Existing Architecture but also at avoiding unintended negative market access and financial stability consequences. As drafted, the Bill leaves many unanswered questions and would benefit from such market consultation.

11. Conclusion

The new draft Article 7 represents a significant departure from the norms and practices which have evolved over many years and now form part of the Existing Architecture. If enacted it is likely to have a major impact in the field of restructuring sovereign debt and will materially alter existing practices and incentives. As drafted, it leaves important questions of detail unanswered, potentially leading to market uncertainty and unintended consequences for sovereign debtors as well as other relevant stakeholders. We anticipate that market participants will be keen to follow its progress through the New York legislative process closely and provide feedback, as appropriate.

For further information at any stage please make direct contact with the authors.

STATE OF NEW YORK

6627

2021-2022 Regular Sessions

IN SENATE

May 10, 2021

Introduced by Sen. RIVERA -- read twice and ordered printed, and when printed to be committed to the Committee on Banks

AN ACT to amend the banking law, in relation to restructuring unsustainable sovereign and subnational debt

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Section 1. The banking law is amended by adding a new article 7 to read as follows:

ARTICLE 7
SOVEREIGN AND SUBNATIONAL DEBT

§ 300. Legislative intent. The purpose of this article is to provide effective mechanisms for restructuring unsustainable sovereign and subnational debt so as to reduce:

1. the social costs of sovereign and subnational debt crises;

2. systemic risk to the financial system;

3. creditor uncertainty; and

4. the need for sovereign and subnational debt bailouts, which are costly and create moral hazard.

§ 301. Definitions. For purposes of this article:

1. "creditor" means a person or entity that has a claim against a state;

EXPLANATION--Matter in *italics* (underscored) is new; matter in brackets [-] is old law to be omitted.

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2. "claim" means a payment claim against a state for monies borrowed or for the state's guarantee of, or other contingent obligation on, monies borrowed; the term "monies borrowed" shall include the following, whether or not it represents the borrowing of money: monies owing under bonds; debentures; notes, or similar instruments; monies owing for the deferred purchase price of property or services, other than trade accounts payable arising in the ordinary course of business; monies owing on capitalized lease obligations; monies owing on or with respect to letters of credit, bankers' acceptances, or other extensions of credit; and monies owing on money market instruments or instruments used to finance trade;

3. "comprehensive audit" means a supervisory action taken to examine and evaluate the public debt contracting, refinancing, or negotiation process, in order to determine the lawfulness, transparency, quality, efficacy, efficiency, and sustainability thereof;

4. "plan" means a debt restructuring plan contemplated by section three hundred five of this article;

5. "state" means a sovereign nation; or unincorporated territory; or any subnational unit thereof, excluding any municipality whose adjustment or debts is governed by 11 U.S.C. 9; and

6. "supervisory authority" means an independent body referred by the New York state senate finance committee.

§ 302. Petition for relief; recognition. 1. A state may invoke application of this article by filing a voluntary petition for relief with the supervisory authority.

2. Such petition shall certify that the state:

(a) seeks relief under this article, and has not previously sought relief under this article, or under any other law that is substantially in the form of this article, during the past ten years;

(b) needs relief under this article to restructure claims that, absent such relief, would constitute unsustainable debt of the state;

(c) agrees to restructure those claims in accordance with this article;

(d) agrees to all other terms, conditions and provisions of this article; and

(e) has duly enacted any national or subnational law needed to effectuate these agreements. If requested by the supervisory authority, such petition shall also attach documents and legal opinions evidencing compliance with this paragraph.

3. Immediately after such a petition for relief has been filed, and so long as such filing has not been dismissed by the supervisory authority for lack of good faith, the terms, conditions, and provisions of this article shall:

(a) apply to the debtor-creditor relationship between the state and its creditors to the extent such relationship is governed by the law of this jurisdiction;

(b) apply to the debtor-creditor relationship between the state and its creditors to the extent such relationship is governed by the law of another jurisdiction that has enacted law substantially in the form of this article; and

(c) be recognized in, and by, all other jurisdictions that have enacted law substantially in the form of this article.

§ 303. Notification of creditors. 1. Within thirty days after filing its petition for relief, the state shall notify all of its known creditors of its intention to negotiate a plan under this article.

2. The supervisory authority shall prepare and maintain a current list of creditors of the state and verify claims for the purposes of supervising voting under this article.

§ 304. Auditing process. 1. A comprehensive audit shall be conducted.

2. The supervisory authority shall choose an independent body to conduct such comprehensive audit.

3. The costs associated with a comprehensive audit shall be borne by the state.

4. The audit process shall abide by the general principles related to the International Standards of Supreme Audit Institutions 100 issued by the International Organization of Supreme Audit Institutions.

§ 305. Submission, contents and voting on plan. 1. The state may submit a plan to its creditors at any time, and may submit alternative plans from time to time.

2. No other person or entity may submit a plan on behalf of the state.

3. A plan shall:

(a) designate classes of claims in accordance with subdivision six of this section;

(b) specify the proposed treatment of each class of claims;

(c) provide the same treatment for each claim of a particular class, unless the holder of a claim agrees to a less favorable treatment;

(d) disclose any claims not included in the plan's classes of claims;

(e) provide adequate means for the plan's implementation including, with respect to any claims, curing or waiving any defaults or changing the maturity dates, principal amount, interest rate, or other terms or canceling or modifying any liens or encumbrances; and

(f) certify that, if the plan becomes effective and binding on the state and its creditors under subdivision four of this section, the state's debt will become sustainable.

4. A plan shall become effective and binding on the state and its creditors when it has been submitted by the state and agreed to by each class of such creditors' claims designated in the plan under subdivision three of this section. Thereupon, the state shall be discharged from all claims included in those classes of claims, except as provided in the plan.

5. A class of claims has agreed to a plan if creditors holding at least two-thirds in amount and more than one-half in number of the claims of such class voting on such plan agree to the plan.

6. Each class of claims shall consist of claims against the state that are equal in priority, provided that:

(a) equal claims need not all be included in the same class;

(b) claims of governmental or multi-governmental entities each shall be classed separately; and

(c) claims that are governed by this article or the law of another jurisdiction that is substantially in the form of this article shall not be classed with other claims.

§ 306. Financing the restructuring. 1. Subject to subdivision three of this section the state shall have the right to borrow money on such terms and conditions as it deems appropriate.

2. The state shall notify all of its known creditors of its intention to borrow under subdivision one of this section, the terms and conditions of the borrowing, and the proposed use of the loan proceeds. Such notice shall also direct those creditors to respond to the supervisory authority within thirty days as to whether they approve or disapprove of such loan.

3. Any such loan shall be approved by creditors holding at least two-thirds in amount of the claims of creditors responding to the supervisory authority within that thirty-day period.

4. In order for the priority of repayment, and corresponding subordination, under section three hundred seven of this article to be effective, any such loan shall additionally be approved by creditors holding at least two-thirds in principal amount of the covered claims of the creditors responding to the supervisory authority within that thirty-day period. Claims shall be deemed to be covered if they are governed by this article or by the law of another jurisdiction that is substantially in the form of this article.

§ 307. Priority of repayment. 1. The state shall repay loans approved under this article prior to paying any other claims.

2. The claims of creditors of the state are subordinated to the extent needed to effectuate the priority payment under this section. Such claims are not subordinated for any other purpose.

3. The priority of payment, and corresponding subordination, under this section is expressly subject to the approval by creditors under subdivision four of section three hundred six of this article.

§ 308. Adjudication of disputes. A court of competent jurisdiction may appoint a referee or a special master to make recommendations to the court regarding the resolution of any disputes arising under this article.

§ 309. Application; opt in. 1. This article applies where, by contract or otherwise,

(a) the law of New York state governs the debtor-creditor relationship between a state and its creditors; and

(b) the application of this article is invoked in accordance with section three hundred two of this article.

2. Where this article applies, it shall operate retroactively and, without limiting the foregoing, shall override any contractual provisions that are inconsistent with the provisions of this article.

3. Any creditors of the state whose claims are not otherwise governed by this article may contractually opt in to this article's terms, conditions, and provisions.

4. The terms, conditions, and provisions of this article shall apply to the debtor-creditor relationship between the state and creditors opting in under subdivision one of this section as if such relationship were governed by the laws of New York state under subdivision three of section three hundred two of this article.

§ 2. This act shall take effect immediately.

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