Chief Minister's Department

Green Paper

States of Jersey

Promotion of debt relief for poorer countries **Date: 15 September 2011**

Purpose and type of consultation:
To seek views on whether Jersey should enact legislation to limit practices that could undermine international debt relief efforts.

Closing date: 8 December 2011

Summary

In the years leading up to the millennium, some of the poorest countries of the world borrowed money from other countries and from institutions such as the World Bank which they later found impossible to repay. This so-called 'sovereign debt' has since proved a major hindrance to their development and in securing a route out of poverty.

In response, the richest countries of the world set in train various international initiatives designed to deal with this problem. These initiatives generally provided for the sovereign debt to be written down or written off as and when the poorer countries showed evidence of their commitment to, and progress in, their own development.

A practice has since emerged where companies, often referred to as 'vulture funds', buy sovereign debt at a substantial discount on the open market and then pursue private legal actions against the poorer country to recover the full sum. Their prospects of obtaining full payment are greatly improved as a direct result of other international debt being written off through one or other of the debt-relief initiatives.

The UK has, uniquely, put legislation in place to limit the sums which can be recovered in legal actions of this type. A recent case in the Royal Court has highlighted the question of whether similar limiting legislation should be enacted in Jersey. This consultation seeks to obtain views on such a proposal.

__Your submission__ Please note that consultation responses may be made public (sent to other interested parties on request, sent to the Scrutiny Office, quoted in a published report, reported in the media, published on www.gov.je, listed on a consultation summary etc.).

If a respondent has a particular wish for confidentiality, such as where the response may concern an individual's private life, or matters of commercial confidentiality, please indicate this clearly when submitting a response.

1. The context of the Consultation

1.1 The millennium saw a concerted effort and renewed ambition in the international community to assist with the development of the poorer countries of the world and to deal with the issue of unsustainable debt.

1.2 The UN Millennium Declaration expressed a determination by UN members to:

"deal comprehensively and effectively with the debt problems of low- and middle-income developing countries, through various national and international measures designed to make their debt sustainable in the long term".

1.3 It called upon the industrialised countries both:

"To implement the enhanced programme of debt relief for the heavily indebted poor countries without further delay and to agree to cancel all official bilateral debts of those countries in return for their making demonstrable commitments to poverty reduction" and

"To grant more generous development assistance, especially to countries that are genuinely making an effort to apply their resources to poverty reduction".[1]

1.4 This consultation paper is set against the background of these international aspirations and the debt relief effort which has surrounded them.

2. The HIPC Initiative and other poverty-reduction initiatives

2.1 In the decades leading up to the 1990s, many of the poorest countries in the world built up substantial debts which proved, and have continued to

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[1] For the full declaration see: http://www.un.org/millennium/declaration/ares552e.htm

prove unmanageable. In servicing these debts some countries were obliged to make payments that were far beyond their means.

2.2 Various private and international policy initiatives were set in train in an attempt to alleviate these problems. A key initiative was the Heavily Indebted Poor Countries (HIPC) Initiative, launched in 1996 with a view to ensuring that no poor country faced an unmanageable debt burden.

2.3 As a result of this Initiative, and an enhanced version which followed a review in 1999, 40 countries (see Box 1) have been identified as having a combination of low average income and unsustainable debt levels.

2.4 For these 40 countries, many of them in sub-Saharan Africa, the enhanced HIPC Initiative establishes a process which allows a potential route out from debt-related poverty.

3. The stages of the HIPC Initiative

3.1 There are two defined stages to be reached under the HIPC Initiative.[2]

3.2 The first stage involves achieving macroeconomic stability and the development of a poverty reduction plan. This brings the country concerned to the "Decision Point". At this point a commitment is given by participating countries and multilateral institutions to reduce their debts to a sustainable level and the 19 permanent members of an informal organisation known as the Paris Club[3] provide immediate interim relief on debt service payments.

3.3 At the Decision Point, a series of goals or 'triggers' are set for that country to achieve the second stage, known as "Completion Point". These triggers are agreed through discussions with the country

[2] For the current stage reached by the 40 countries in the HIPC Initiative see: http://go.worldbank.org/4IMVXTQ090 or http://www.imf.org/external/np/exr/facts/hipc.htm

[3] For further details of the membership and constitution of the Paris Club, see http://www.clubdeparis.org/en

concerned, the International Monetary Fund (IMF) and the World Bank. They seek to guarantee that the debt relief obtained or promised at Decision Point is directed towards the reduction of poverty and building economic growth.

Box 1 – The 40 HIPCs		
Afghanistan	*Benin*	*Burkina Faso*
Burundi	*Cameroon*	*Central African Republic*
Chad	*Comoros*	*Côte d'Ivoire*
Democratic Rep of Congo	*Eritrea*	*Ethiopia*
Ghana	*Guinea*	*Guinea-Bissau*
Guyana	*Haiti*	*Honduras*
Kyrgyz Republic	*Liberia*	*Madagascar*
Malawi	*Mali*	*Mauritania*
Mozambique	*Nicaragua*	*Níger*
Plurinational State of Bolivia	*Republic of Congo*	*Rwanda*
São Tomé Príncipe	*Senegal*	*Sierra Leone*
Somalia	*Sudan*	*Tanzania*
The Gambia	*Togo*	*Uganda*

3.4 The IMF and World Bank also calculate the percentage of debt reduction which, if agreed by all relevant creditors, would reduce the country's indebtedness to a sustainable level. The "Common Reduction Factor" is published within the Decision Point document[4], and sets the reduction expected from all creditors after they have provided so-called 'traditional relief' at 67%[5].

3.5 By way of example, if the Common Reduction Factor is set at 33%, a debt of £100 would first be reduced by traditional relief at 67%. The remaining £33 would then be further reduced by the 33% Common Reduction Factor to give a final figure for the debt at £22.

3.6 When the Decision Point triggers are achieved and the Completion point reached, the Paris Club and principal multilateral institutions (the IMF,

4 The Decision Point documents produced for those countries which have reached this stage are available at http://go.worldbank.org/9W8I0X55A0

5 This 'traditional relief' derives from the Paris Club's 'Naples terms', agreed in 1994.

World Bank etc) cancel their debt to the extent mandated by the Common Reduction Factor.

3.7 Under the separate Multilateral Debt Relief Initiative (MDRI)[6] some multilateral institutions provide 100% cancellation of debt at this stage. As a matter of practice, the UK and many other major creditor countries do likewise (thereby going beyond the requirements of the HIPC Initiative).

4. The rise of the 'vulture fund'

4.1 When a company becomes insolvent, relevant domestic laws generally provide for a process in which all creditors become subject to the same insolvency scheme and all realise the same proportionate loss on the sums they are owed. Despite various proposals, there is no similar worldwide scheme which operates in relation to countries and to sovereign (i.e. government) debt.

4.2 The voluntary nature of the HIPC Initiative and other initiatives can lead to a so-called 'free rider' problem where one creditor country refuses to participate and, instead, continues to pursue its debt in full against the debtor country concerned. It is, of course, legally entitled to do so as the HIPC Initiative does not alter any legal rights and liabilities as between HIPCs and their external creditors.

4.3 That said, any success by a creditor litigant in such circumstances is inevitably at the expense of the other creditors. Action of this type taken against HIPCs proves particularly inequitable to those creditors who, voluntarily, have cancelled their own debt in an effort to help the HIPC climb out of poverty.

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6 Formerly the G8 proposal for debt relief; see http://www.imf.org/external/np/exr/facts/mdri.htm

4.4 The issue may be exacerbated where the sovereign debt is not being pursued by the original creditor but by a third party (often a company or fund) that has bought sovereign debt owed by a HIPC on the open market. Given that the prospects of repayment by the HIPC are considered poor, the market value of the debt being sold is usually very low in comparison to its face value.

4.5 The purchasing party then chooses not to participate in the HIPC Initiative or any other debt-reduction initiative. Instead it 'holds out', perhaps whilst the HIPC in question reaches Decision Point and Completion Point with the consequential release and reduction of much of that country's other debts. It then claims the full value of the debt and interest and seeks enforcement by pursuing the country's assets through the courts in the jurisdiction where those assets are held. Companies and funds that carry on such activities have been labelled 'vulture funds' and, generally speaking, attract moral censure (see Box 2)

Box 2 - Vulture Funds in the Sovereign Debt Context (excerpt)[7]

"The central criticism of the vulture funds is that, by purchasing distressed debt at discounted rates, refusing to participate in voluntary restructurings, and seeking to recover the full value of the debt through litigation, vulture funds are preying on both other creditors and on the indebted countries themselves. Countries whose debt is trading at deep discounts are almost by definition in deep financial trouble and many of them are poor. Holdout behaviour by vulture funds makes restructuring slower, more difficult, and uncertain. Debtors are harmed by the substantial uncertainty faced and also by being forced to repay individual creditors far more than the agreements negotiated with other creditors."

[7] *Excerpted from "The African Legal Support Facility Website*": http://www.afdb.org/en/topics-and-sectors/initiatives-partnerships/african-legal-support-facility/vulture-funds-in-the-sovereign-debt-context/

4.6 'Vulture fund' is a term which is equally applied to companies and funds which pursue distressed commercial debt (as opposed to sovereign debt). In what follows, however, the use of this term is restricted to those companies and funds which have purchased sovereign debt with the intention of adopting a holdout strategy and pursuit of a profit through all available means including claiming through the courts.

4.7 Perhaps the most commonly cited example of vulture fund practice was the 2007 UK case of *Donegal International Ltd v Republic of Zambia.* In this case, a $15 million debt from Zambia (a HIPC) to Romania was sold for $3.2 million to Donegal International Ltd, a company incorporated in the British Virgin Islands. After unsuccessful negotiations and attempts at binding settlement, Donegal eventually sued Zambia in the UK High Court for more than $55 million. Zambia's liabilities were eventually assessed at approximately $15 million[8].

5. The extent of the problem

5.1 Since the HIPC Initiative was launched, it is reported that at least half of all HIPCs have been targeted by vulture funds at one time or another.

5.2 An annual survey is conducted by the IMF to determine the extent of the problem. The *HIPC Status of Implementation Report 2010* (hereafter the *IMF 2010 Report*)[9] suggests that, as at September 2010, there were 17 current lawsuits against 9 HIPCs totalling some $1.22 billion, with unenforced judgments having been given for $183 million of that figure. Over 75% by value of the outstanding claims are directed towards the Republic of Congo and the neighbouring Democratic Republic of Congo.

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8 Official case report: http://www.bailii.org/ew/cases/EWHC/Comm/2007/197.html
BBC News report at http://news.bbc.co.uk/1/hi/6365433.stm

9 A full copy of the report can be found at
http://www.imf.org/external/pp/longres.aspx?id=4481
By the close of the consultation period, the 2011 Report may well be available.

6. Non-legislative action to limit claims by vulture funds

6.1 There has been concerted action by the international community and, indeed, the markets themselves to limit the vulnerability of HIPCs to vulture fund claims.

6.2 In 1989, the World Bank established a Debt Reduction Facility for countries in the International Development Association (IDA), many of whom are also HIPCs. This facility continues to provide funding which allows participating governments to buy back sovereign debt from creditors at a heavy discount. It has resulted in the extinguishment of over $13.8 billion of debt and interest from IDA countries, including 18 HIPCs[10].

6.3 In 2007, the G7 urged all sovereign creditors not to sell on HIPC sovereign debt[11] and there has since been commitment by the Paris Club, EU Members and the signatories to the UN's Doha Declaration on Financing for Development[12] to restrict any sale of such debt to creditors who participate in the HIPC Initiative.

6.4 The African Legal Support Facility was established by the African Development Bank at the end of 2008. One of its clearly stated aims is to assist Regional Member Countries with technical legal advice in dealing with lawsuits and other claims brought by vulture funds.

7. Legislative Action to limit claims by vulture funds

7.1 Set against this, worldwide legislative action appears by all accounts to have been minimal.

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[10] Source: http://go.worldbank.org/2CRHS4N500
[11] See statement of G7 Finance Ministers & Central Bank Governors, Washington Oct 2007 http://www.g7.utoronto.ca/finance/fm071019.htm
[12] See para 60 of the Doha Declaration http://www.un.org/esa/ffd/doha/documents/Doha_Declaration_FFD.pdf

7.2 Legislation was proposed (unsuccessfully) in the National Assembly of France in 2007 and 2008[13].

7.3 As at September 2010, the *IMF 2010 Report* speaks to only three other attempts at legislative intervention.

7.4 It reports that a Belgian law of May 2008 ensured that Belgian development loans could not be seized or transferred, irrespective of applicable law or any waiving clauses in the contract. This provided limited protection to low-income countries in receipt of such loans.

7.5 In the US, the "Stop VULTURE Funds" Bill was introduced to Congress in June 2009[14]. It was designed to limit the ability of non-participating creditors to seek awards from HIPCs via US courts. The Bill was referred to the Subcommittee on Courts and Competition Policy but by the close of the 111th Congress had not been passed. As a result, it was cleared from the books and never became law. It remains to be seen whether it will be introduced again in the current 112th Congress (which commenced on 3 January 2011).

7.6 Although the *IMF 2010 Report* confirms ongoing lawsuits in various jurisdictions around the world, including France, Sweden, USA and Russia (all Paris Club Members), the UK is the only jurisdiction in the world to date to have enacted 'anti-vulture fund' legislation.

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13 See www.assemblee-nationale.fr/12/propositions/pion3214.asp and www.assemblee-nationale.fr/13/propositions/pion0131.asp

14 H R 2932 introduced by Maxine Waters, a democratic member of the House of Representatives: see http://hdl.loc.gov/loc.uscongress/legislation.111hr2932

8. The Debt Relief (Developing Countries) Act 2010

8.1 On 21 July 2009, the UK government consulted on legislation 'to ensure the effectiveness of debt relief for poor countries'[15]. The consultation proposed that, in addition to the existing non-legislative measures (such as those summarised above), complimentary legislation should be enacted to prevent creditors of HIPCs pursuing excessive recoveries on their debts through the UK courts and undermining the debt relief effort provided by other creditors (such as the UK government).

8.2 The consultation generated an email campaign urging legislative action and 23 written responses from businesses, organisations and individuals.

8.3 The Debt Relief (Developing Countries) Act 2010[16] was enacted on 8 April 2010 and came into force on 8 June 2010. In broad terms, the Act sought to limit the proportion of a sovereign debt that any commercial creditor could reclaim through litigation under UK law. This limit was set in each case by direct reference to the Common Reduction Factor calculated by the IMF and the World Bank for the HIPC in question. For those HIPCs who had yet to reach Decision Point and be given a CRF, the 'traditional' 67% discount was imposed. Box 3 highlights the key elements.

8.4 The Act was initially temporary, with a 'sunset clause' ensuring that it continued in force only until 8 June 2011. However, it has since been made permanent[17].

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15 Copies of the consultation, impact assessment, responses and UK government response are available on the UK government electronic archive: http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/consult_debt_relief.htm

16 http://www.legislation.gov.uk/ukpga/2010/22/contents

17 See the Debt Relief (Developing Countries) Act 2010 (Permanent Effect) Order 2011: see http://www.legislation.gov.uk/uksi/2011/1336/contents/made

Box 3 - The UK Debt Relief Act

debts previously contracted by a HIPC that a commercial creditor can reclaim through litigation under UK law.

The chief aim is to ensure that the burden of debt relief is shared and that resources provided through debt relief and intended to support development and poverty reduction in the country are not diverted.

The key elements of the Act are as follows:

- The debt affected by the Act is the debt eligible for relief under the HIPC Initiative, but is limited to HIPC debt incurred prior to a HIPC's Decision Point and prior to the commencement of the Act.
- Qualifying debt is limited to the HIPC eligibility criteria as at the commencement of the Act. Any changes to HIPC criteria going forward (e.g. new countries being added to the list of HIPCs) are disregarded by the Act. In this way the Act restricts its ambit to an identifiable stock of historic debt though makes no distinction between HIPC debt still held by the original creditor and that which has been traded on the markets.
- The Act limits the amount of qualifying debt (and associated causes of action such as damages claims) recoverable by a creditor in the UK courts to the amount the creditor would have received if it had applied the most recently published Common Reduction Factor set by the IMF and World Bank under the HIPC Initiative (on top of traditional relief).
- For the five countries that had not yet reached Decision Point at the time the Act was passed, no Common Reduction Factor was available. For these countries, the Act applies only the 67% ‘traditional relief’, leaving 33% payable. It was thought that this would encourage creditors to settle with the five pre-Decision Point HIPCs before they reach Decision Point.
- In addition to reducing the recoverable amount on due debts, the Act also applies the same reduction to any qualifying debts on which judgment has been obtained but not yet enforced. In this sense, the Act might be considered to have a ‘retrospective’ element.
- Qualifying debt includes HIPC debt governed by foreign law as well as UK law i.e. it will apply to cases decided by UK courts using foreign governing law.
- The Act promotes the negotiated settlement of qualifying debts by excluding from the scope of the Act any debts where the HIPC government concerned does not offer to negotiate.

9. The effect of non-legislative and legislative action

9.1 The most recently published evidence does suggest that the legislative and non-legislative measures taken around the world are taking effect.

9.2 Whilst some reports suggest otherwise, there is now reliable evidence emerging of a decrease in vulture fund litigation. The *IMF 2010 Report* reported that its annual survey of HIPCs showed only one new lawsuit (against the Kyrgyz Republic) to have been initiated in the year to September 2010[18].

9.3 That said, this apparent decrease in litigation should not necessarily undermine the continuing importance of the issue given that, in many instances, the sums involved even in one claim can be substantial.

10. The case of *Hemisphere v Democratic Republic of Congo*

10.1 Jersey currently has no equivalent legislation to the UK's Debt Relief (Developing Countries) Act 2010. This has been noted internationally[19], in part as a result of a recent decision of the Royal Court.

10.2 The case of *FG Hemisphere Associates LLC v Democratic Republic of Congo & Others*[20] (27 October 2010) concerned the enforcement against a Jersey company of a 2003 arbitration award against the Democratic Republic of Congo (see Box 4 for summary).

[18] http://www.imf.org/external/pp/longres.aspx?id=4481 at paragraph 26 (and Table 16). It should be noted also that these figures report the response of 37 of the 40 HIPCs and that they do not discriminate between claims brought by original sovereign creditors and those brought by so-called 'vulture funds'

[19] See for example, the comments of Dr Cephas Lumina; UN Daily News 19 May 2011 http://www.un.org/apps/news/story.asp?NewsID=38437&Cr=debt&Cr1=

[20] [2010] JRC 195. Delivered on 27 October 2010 and available as an unreported judgment on http://www.jerseylaw.je

21 [2011] JCA 141. Delivered on 14 July 2011 and available as an unreported judgment on http://www.jerseylaw.je

11. Vulture funds and Jersey – the current position

11.1 There is currently no evidence that vulture funds themselves are or have been constituted in Jersey, though some are certainly constituted in other less well-regulated jurisdictions.

11.2 The Jersey Financial Services Commission (the "Commission") has published a Sensitive Activities Policy[22]. Amongst other things, this policy requires information on "sensitive activities" to be provided at the time of an application under Article 2 of the Control of Borrowing (Jersey) Order 1958 ("COBO"). This is to enable the Commission to determine whether to give consent for a company to issue shares or make such consent subject to conditions.

11.3 In applying this policy the Commission is mindful of the requirements, in both Article 2(3) of the Control of Borrowing (Jersey) Law 1947 and Article 7 of the Financial Services Commission (Jersey) Law 1998, to have regard to the need to protect and enhance the integrity of Jersey in commercial and financial matters and to safeguard the best economic interests of Jersey.

11.4 In line with these requirements, where an application is made under Article 2 of COBO in respect of a company that proposes to buy discounted debt issued by a HIPC and then to seek to recover the full value of that debt (or greater amount), the Commission will not consent to the issue of shares. This accords with a statement made by the Chief Minister to the States Assembly on 19 June 2007[23]. Where it is proposed that a unit trust or partnership will be similarly engaged, the Commission will not consent to the issue units or creation of partnership interests.

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22 See: www.jerseyfsc.org/the_commission/general_information/policy_statements_and_guidance_notes/

23 See: http://www.statesassembly.gov.je/documents/hansard/2984-4803-1372007.htm#_Toc170638554

11.5 Whilst the Sensitive Activities Policy is currently under review, the Commission does not propose to change this approach. However, it is intended that the policy should also clearly be expressed as applying to unit trusts, limited partnerships, limited liability partnerships, separate limited partnerships and incorporated limited partnerships. It should also explain how the policy is applied after consent has been given to issue shares, units or interests.

11.6 Given the powers and stated stance of the Commission on these matters, it is likely that any future involvement by Jersey with vulture funds will be restricted to its identification as a jurisdiction with assets vulnerable to enforcement or execution claims by such vehicles (as in the case of *Hemisphere*).

12. Vulture funds and Jersey – the future?

12.1 As mentioned above, the recent *Hemisphere* case has caused concerns to be expressed both by members of the public and by members of the States as well as attracting the attention of local and international media. This concern has tended to focus around the question of whether vulture funds should be allowed to pursue enforcement actions through the Royal Court. It has resulted in calls for the enactment of legislation equivalent to that in the UK.

12.2 Jersey is, in myriad ways, a jurisdiction different from that of the UK, not least in its commercial, fiscal and international profile. The chief purpose of this consultation is to gather views over the extent to which such differences affect the moral and practical imperatives for enacting equivalent legislation.

12.3 Clearly, in deciding how this issue is taken forward, the maintenance of Jersey's international reputation will be a key consideration. It will be necessary both to preserve Jersey's commercial reputation as a jurisdiction which honours and enforces the sanctity of contractual relations and to maintain Jersey's political reputation as a transparent, well-regulated and respected international finance centre.

12.4 The development of the UK law has provided not only a model deserving of full consideration but also a rich resource of material and analyses of the many arguments both for and against the introduction of legislation of this type. In preparing their own representations, respondents may find some considerable benefit in consulting the HM Treasury documentation (referenced above), including the responses to consultation.

12.5 Responses are sought generally on the issues raised and, in particular, to the following questions

Question 1: Should Jersey enact legislation equivalent to the UK Debt Relief (Developing Countries) Act 2010 to help curb the ability of vulture funds to pursue sovereign debt through the Jersey courts?

Question 2: Are there any unique aspects of Jersey's political, commercial or financial profile which are not present in the UK and which would require specific consideration?

Question 3: Should the maximum recovery percentage be pegged to the Common Reduction Factor (as in the UK) or utilise a different benchmarking criteria (e.g. the amount paid for any sovereign debt purchased on the secondary market)?

Question 4: Should any other parameters (e.g. the list of countries which benefit, the application of the Act to original commercial creditors as well as 'vulture funds' etc) otherwise be broader or narrower than the UK Act and, if so, in what particular respect?

Question 5: Are there other non-legislative measures which Jersey might usefully consider to discourage vulture funds from taking action in Jersey and, if so, what would these measures entail?

Question 6: What reputational impact is UK-equivalent legislation likely to have on Jersey?

Question 7: Given that sovereign debt can be legitimately purchased and pursued in almost all major jurisdictions around the world, is the Commission's sensitive activities policy, as it is applied to vulture funds, the correct one in light of its primary obligation to protect Jersey's integrity and reputation in commercial and financial matters?

Question 8: Other than the case of *Hemisphere v DRC*, what evidence exists of foreign vulture funds or commercial creditors using or aspiring to use Jersey as a jurisdiction to institute or continue litigation against HIPCs for the recovery of sovereign debt?

Question 9: To what extent are assets owned (directly or indirectly) by HIPCs considered likely to be held in Jersey and thereby vulnerable to future enforcement action by vulture funds?

How to respond

The deadline for responses is **8 December 2011**.

All respondents should indicate the capacity in which they are responding (i.e. as an individual, company, representative body etc). If you are responding as a company or representative body, please indicate the nature of your business and/or your clients' business. Representative bodies should identify on whose behalf they are responding and the methodology they used to gather responses.

Responses and any additional comments may be sent to any of the following:

Debt Relief Consultation
Chief Minister's Department
Cyril Le Marquand House
PO Box 140
St Helier
JE4 8QT

Email: debtreliefconsultation@gov.je

Jersey Finance Limited will co-ordinate an industry response incorporating any matters raised by local firms or entities.

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Your submission *Please note that consultation responses may be made public (sent to other interested parties on request, sent to the Scrutiny Office, quoted in a published report, reported in the media, published on www.gov.je, listed on a consultation summary etc.).*

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