INTERNATIONAL LAW ASSOCIATION

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COMMITTEE ON INTERNATIONAL MONETARY LAW

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Observers:

Professor Christoph Ohler (Germany)

Introduction

Since the last Conference of the ILA, held in Johannesburg, South Africa, in August 2016, the Committee (generally known by its acronym, MOCOMILA) has held two meetings: in London, England (6-7 July 2017), and Barcelona, Spain (18-19 May 2018).[1] The London meeting was held at the Bank of England and was jointly hosted by the Queen Mary University of London (Centre for Commercial Law Studies), the Bank of England, and MOCOMILA. The meeting focused on the theme of Accountability, and featured talks by Dr Benjamin Broadbent, Deputy Governor for Monetary Policy at the Bank of England, and Mr Sam Woods, Deputy Governor of the Bank of England and Chief Executive Officer of the Prudential Regulation Authority. The Barcelona conference was held at IESE Business School and sponsored by CaixaBank S.A. It focused on developments in the European Union, other international developments, and innovation in finance.

[1] MOCOMILA had a third meeting planned in Mexico City, Mexico, for 20-21 October 2017. Unfortunately, because of the earthquake in Mexico the month before, we were forced to cancel that meeting.

The subjects of the foregoing meetings and other topics discussed by the Committee are reflected in the following sections of this report.

I. Judicial Control of ECB Monetary Policy (by Mr B Krauskopf)

II. Finalization of Basel III (by Mr E Fernandez-Bollo)

III. Addressing Corruption: Enhanced IMF Engagement (by Mr S Hagan)

IV. Regulatory Developments Related to the European Banking Union (2016-2018) (by Professor C Gortsos)

V. Cross-Border Resolution (by Dr E Hüpkes)

VI. The Emerging International Law of Sovereign Debt Restructuring – Recent Developments (by Professor R Bismuth)

VII. Recent Developments in Sovereign-Debt Restructuring (by Mr M Jewett)

VIII. Moving to a 'Direct Delivery' Model for the UK's High-Value Payment System (by Ms S Branch)

IX. Central Bank Digital Currencies (CBDC) Tokenized Schemes – An Overview (by Professor B Geva)

X. Update on the Current Regulatory State of Fintech in the EU (by Dr K P Follak)

This report reflects the views of the individual members and not necessarily those of any institutions with which they are affiliated.

I. Judicial Control of ECB Monetary Policy

When interest rates on the sovereign bonds of some euro area Member States failed to stop rising, the ECB in September 2012 publicly announced its OMT programme. This programme provides for outright purchases by the ECB and the Eurosystem NCBs of low-rated government bonds of selected Member States in the secondary markets without pre-announced quantitative limits.

1. After OMT was announced, German citizens lodged constitutional complaints before the German Constitutional Court (*Bundesverfassungsgericht* or BVerfG). They claimed that OMT is an *ultra vires* act, as it is not within the ECB mandate and does not comply with the prohibition of monetary financing. They also argued that the budgetary autonomy of the German Parliament, which is part of the German constitutional identity, could be violated if the Deutsche Bundesbank suffered losses as a result of the OMT programme.

The possibility of a national constitutional court, the German BVerfG, reviewing acts passed by the ECB as an institution of the European Union has to be seen against the backdrop of the principle of conferral and the transfer of competences from the Member States to the European Union.

The European Union shall only act within the limits of the competences transferred upon it by the Member States in the European Treaties. This is also the case for the ECB. Member States transferred the competence for monetary policy to the ECB. Competences in the area of fiscal and economic policy remain within the responsibility of the Member States.

The BVerfG reviews whether institutions of the European Union are acting within the limits of the competences conferred upon them by the German Act of Approval. This *ultra vires* review is based on the fact that the German Parliament's Act of Approval is the basis for the application of acts of the European Union in Germany.

The BVerfG may also review whether acts of the European Union violate the German constitutional identity which, *inter alia*, encompasses the principle of democracy and the budgetary autonomy of the German Parliament. For historic reasons, the German constitution has an immutable core (the constitutional identity), which may not be altered by any public authority measure including acts of the European Union.

2. In January 2014, the BVerfG referred several questions about the legality and interpretation of the OMT programme to the European Court of Justice (ECJ) for a preliminary ruling. The BVerfG asked the ECJ whether the OMT programme is compatible with the ECB's monetary policy mandate and with the prohibition of monetary financing. Since the BVerfG exercises its powers to review in a European-friendly manner, it will only declare an act to be *ultra vires* after the ECJ has been given the opportunity to rule on the legality of the act in question.

The BVerfG asked the ECJ for a ruling on the basis that there are reasons to assume that the OMT programme does not comply with the mandate of the ECB and the prohibition of monetary financing of the budget. The BVerfG saw grounds to believe that the OMT decision was an act of economic policy, which is the responsibility of the Member States. The framework of the European System of Central Banks (ESCB) does not differentiate between individual Member States, it stated. In addition, the neutralisation of interest rate spreads and interference with price formation on the market indicated that OMT would violate the prohibition of monetary financing.

The BVerfG, however, built a bridge for the ECJ. In the view of the BVerfG, the ECB's decision on OMT might nonetheless not constitute an *ultra vires* act, if it could be interpreted or limited in conformity with EU law. The BVerfG would then have no reason to assume that OMT is *ultra vires* with respect to German constitutional law.

3. On 16 June 2015, the ECJ made a judgement on the OMT programme, ruling that OMT is compatible with EU law, but must have safeguards ensuring that it complies with the prohibition of monetary financing. Based on this, the BVerfG, in its final judgement on the OMT programme on 21 June 2016, decided that, if interpreted in accordance with the conditions intended to limit the scope of the OMT programme as defined by the ECJ, the ECB's OMT decision does not constitute an *ultra vires* act. In that case, the OMT programme would not impair the German Parliament's overall budgetary responsibility either.

Nevertheless, the BVerfG did not refrain from criticising the ECJ's ruling and stated that, if OMT was ever activated and purchases were made, the Deutsche Bundesbank would only have to participate in the implementation of OMT if the safeguards established by the ECJ were adhered to.

4. The judgements of both the ECJ and the BVerfG mark another important step towards a reasonable cooperation between the highest courts at the European and the national level respecting their fields of competence.

The ECJ is clearly responsible for interpreting EU law and thus, for instance, for answering the question of whether the ECB is acting within its mandate based on EU law. If doubts and questions arise at the national constitutional level, the national constitutional courts must give the ECJ the possibility of expressing its view as to the compatibility with and the interpretation of EU law. However, if the ECJ's interpretation of EU law leads to an extension of the competences of EU institutions, thus giving the EU competences which were not transferred to the EU level by a German Act of Approval (which serves as a bridge between national and EU law in Germany), it is up to the BVerfG to decide on the consequences of such an extension according to the German constitution.

5. Even though the ECB is obviously not bound by the BVerfG's judgement regarding OMT, the BVerfG ruling can be seen to have had an influence when looking at the parameters of the ECB's next outright programme. This programme, the Expanded Asset Purchase Programme (EAPP), which includes the Public Sector Purchase Programme (PSPP), contains safeguards developed by the ECJ and the BVerfG.

6. In September 2015, the Governing Council of the ECB decided to purchase public sector securities under the PSPP. German citizens lodged constitutional complaints against the PSPP, too.

With its order of 18 July 2017, published 15 August 2017, the BVerfG again adopted an order referring several questions regarding the compatibility of the PSPP with EU law to the ECJ for a preliminary ruling. Once more, the BVerfG saw significant evidence to suggest that the ECB decisions governing the PSPP might be an *ultra vires* act.

The BVerfG took the prerequisites and safeguards established by the ECJ in its OMT judgement and stipulated them as general safeguards to be adhered to in any purchase programme. On this basis, the BVerfG stated its reasons for assuming that the PSPP violates the prohibition of monetary financing, which is intended to ensure budgetary discipline on the part of Member States.

In addition, the BVerfG took the view that the ECB's mandate might be violated. Even though the PSPP has a monetary policy objective and uses monetary policy instruments, the monetary policy impact of the programme is limited. In contrast to that, the economic policy consequences seem to be significant, especially when weighing up the monetary policy impact against the economic policy impact.

Furthermore, the BVerfG ruled that unlimited risk-sharing within the Eurosystem would amount to a violation of the budgetary autonomy of the German Parliament if it could be affected by PSPP in terms of potential losses to be borne by the Deutsche Bundesbank. A violation of the constitutional identity depends on whether risk-sharing can be ruled out for PSPP.

Now it is for the ECJ to render its judgement on the compatibility of the PSPP with European Union law. The ECJ can be expected to further elaborate on the safeguards and prerequisites it had developed in its OMT judgement.

7. All in all, the proceedings strengthen the rule of law as one of the core values of the EU (EU as legal community / "Rechtsgemeinschaft"). The ECJ affirmed in its OMT judgement that acts of the ECB are not exempted from judicial review, in particular with regard to the question of whether they comply with the principles of conferral and proportionality. Also, the proceedings lead to an interpretation of EU law and fundamental rules of the Monetary Union, defining their respective boundaries. For example, the ECJ and BVerfG unanimously agreed on an interpretation of Article 123 TFEU as a wide prohibition of monetary financing by ruling that secondary market purchases of government bonds, too, must have sufficient safeguards to avoid circumventions. Thus, the proceedings finally set requirements for (new) asset purchase programmes on the part of the Eurosystem and thereby strengthen legal certainty in this area.

II. Finalization of Basel III

On 7 December 2017, the Basel Committee's oversight body, the Group of Central Bank Governors and Heads of Supervision (GHOS), endorsed the outstanding Basel III post-crisis regulatory reforms.

This agreement comes seven years after the application of its first components: in 2010, important changes to the international regulatory framework had improved the quality and increased the level of banks' capital, introduced capital buffers, constrained excess leverage in the banking system and mitigated excessive liquidity risk and maturity transformation.

The completion of the agreement is in itself an important event, preserving an international standard that, albeit in a purely informal framework, is one of the oldest truly common global standards. It applies furthermore in a sector that is key for global financial stability, so the credibility of the post-financial crisis measures would have been severely hit if one of its key pieces would have been left unfinished.

The key technical feature to reach this agreement has been to strike the right balance between keeping a difference between banks that engage in low-risk business and those whose appetite to take risks is stronger, while limiting the possibility of the banks to reduce too much the need to cover risks by their own funds, to ensure thus the protection of ordinary creditors and depositors.

These new standards affect almost all components of banks' requirements to hold their own funds against the different risks they take. It covers not only credit risk and market risk, but also operational

risk, that is, the risk of a loss due to operational problems, and also bad execution of contracts or compliance problems, losses that have been substantial for some banks since the crisis. It also reinforces the leverage ratio that the most important banks (globally systemic banks) are required to hold.

A very important feature of this agreement has been the renewed commitment of all the parties, which comprise the central banks and banking supervisors of all G-20 countries, to implement all its components at a given time. This implementation date, given the importance of the changes, goes with a transitional arrangement that begins in 2022 and ends in 2027. This phased implementation is a key factor to fulfill the mandate previously granted to the Committee, i.e., that the finalization of Basel III should not lead to an overall significant increase of capital requirements. Actually, strengthening the quantity and the quality of capital has already been achieved by the previous steps of the post-crisis reforms (e.g., from 2008 to 2016, the CET1 ratio of the sample of the largest banks worldwide has increased from 5.8% to 13.2%). This agreement definitively stabilises the rules for banks and clarifies them over the long term. It is "a *major milestone that will make the capital framework more robust and improve confidence in banking systems*".[2]

A long post-crisis regulatory program has been achieved and the financial sector can now deal with a new set of rules. This ensures a level playing field and a strong regulation that leads to a better resilience of internationally active banks, which is key for stabilizing the financing of the economy.

III. Addressing Corruption: Enhanced IMF Engagement

Corruption is universally recognized as an urgent global problem. The growing number of high profile cases involving the abuse of the system by well-placed individuals has generated moral outrage, particularly at a time of rising inequality. However, there is abundant evidence that systemic corruption can also have important adverse economic consequences, which is why the IMF has recently adopted a decision that will enable it to address this problem in a more robust way—in all of its activities.

Understanding Corruption: Definitions and Typologies

Corruption is often defined as the "abuse of public office for private gain". A key issue, however, is the meaning of "abuse". While a survey of the practice and academic literature reveals a diversity of approaches, it is relatively clear that – at a minimum – the international community recognizes "corrupt" acts as those that involve criminality. In particular, the United Nations Convention Against Corruption (UNCAC), which 183 state parties have ratified, identifies a core set of corrupt acts that state parties are required to criminalize, including the offering and accepting of bribes involving a public official and embezzlement by a public official.

In addition to this definitional issue, it is clear that corruption can arise in a number of different contexts. For example, a bribe may be "extortive" or "collusive". In cases of "extortive" corruption**,** an official coerces a benefit from a private party by threatening an adverse official act if the private party does not comply. By contrast, in cases of "collusive" corruption, a private party initiates the transaction – or at least is a willing participant. A distinction may be made between "incidental" and "systemic" corruption: corruption is "incidental" when it is the exception to the norm; it is "systemic" when it becomes the norm itself. Finally, it is helpful to distinguish between "administrative corruption", which refers to corruption in the implementation of laws and regulations and "state capture", where the very legal framework is fixed in advance to favor those who bribed the lawmakers.

The Economic Impact

A considerable amount of research – conducted both within and outside the IMF – reveals the extent to which corruption can undermine sustainable and inclusive growth. In particular, when corruption is systemic, it can undermine the government's ability to deliver important economic public goods. The

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[2] Mario Draghi, chair of the GHoS, 7 December 2017.

functions that are affected include the conduct of fiscal and monetary policies, the design and implementation of market regulation, financial sector oversight, and rule of law.

Regarding fiscal policy (tax and spending), a weak culture of tax compliance and a high rate of tax evasion can result in economic instability as the government is forced to accumulate substantial debt that can quickly become unsustainable. With respect to expenditure, systemic corruption distorts spending decisions towards wasteful, large projects that generate kickbacks, and away from more economically and socially valuable investments in areas such as health and education. Corrupt procurement practices waste public resources, undermining the ability of the government to provide much-needed social services. Because they rely more heavily on government services, the poor are disproportionately affected by these distortions, thereby entrenching poverty and inequality.

Systemic corruption also limits the ability of the government to create an environment that attracts private investment. Because bribes make investments more expensive, corruption can be seen as a tax on investment. Perhaps even more importantly, for an investor considering a large capital investment, the prospect of having to pay a continuous series of bribes may create such uncertainty that it dissuades him or her from making the investment in the first place.

More generally, systemic corruption weakens the social fabric with a disproportionate impact on the youth. When young people see that what is important is *who* you know rather than *what* you know, it can undermine their incentive to pursue an education. At its extreme, corruption can create civil unrest and armed conflict—with devastating economic and human consequences.

Addressing Corruption

When thinking about a coherent anti-corruption strategy, it is important to acknowledge that there is no quick fix. A holistic approach is needed and, based on the IMF's own experience, there are four key elements of an effective anti-corruption strategy: transparency, enhancing the rule of law, economic reform, and building institutions.

In addition to promoting efficiency and sound decision-making, transparency is a very effective anti-corruption tool. This is hardly surprising because corruption, being illegal, thrives on secrecy and opaque structures. In its own work, the IMF promotes compliance with international standards aimed at enhancing transparency in the area of data dissemination, fiscal policy, and monetary and financial policy.

Enhancing the rule of law is central. A credible threat of prosecution of corrupt officials acts as an important incentive. However, in countries where corruption is systemic, the institutions charged with prosecution of corruption may themselves be corrupt. In these cases, experience has revealed that it may be necessary to establish and empower new institutions even for a transitional period until adequate capacity is developed. Importantly, governments should tackle not just public officials who receive bribes, but should also prosecute private sector operatives who pay bribes as well as those private actors who facilitate the laundering of proceeds.

The third element is economic reform. While regulation is essential in any market economy, steps need to be taken to address excessive regulation, especially where the regulatory process is opaque. Technology is a particular useful mechanism in this regard, since it can remove the exercise of discretion in simple approval processes, thereby limiting the ability for officials to solicit bribes. More generally, it is not possible to address corruption without addressing the broader regulatory and administrative vulnerabilities that create the opportunities for corruption. In sum, addressing corruption means addressing governance weaknesses more generally.

Finally, and perhaps most importantly, is institutional reform. In fact, a reform agenda is only as good as the officials charged with implementing its elements – whether it is the courts, prosecutors, tax officials, bank regulators or customs personnel. To succeed, reform efforts should seek to develop a cadre of competent public officials who are independent of both private influence and political interference. This requires a clear legal framework that establishes and empowers the respective institutions; technical expertise of the officials; clear incentive systems for public officials, rewarding professionalism and competence while punishing improper conduct. But perhaps, most importantly, it requires effective leadership. There are a number of examples of leaders who, through their own

integrity and attitude of zero-tolerance, have transformed the norms of behavior of public officials in a relatively short period of time.

The IMF's Role

As early as 1997, the IMF articulated a policy for addressing governance and corruption in member countries – building in part on our experience up to that time. In 2017, twenty years after the policy on governance and corruption was first adopted, the IMF examined its experience with respect to the implementation of the 1997 policy. It is fair to say that the review showed that, while the IMF had made progress, more work is needed. In particular, there is a recognition that in order to be effective, the IMF needs to develop a more systematic approach when assessing both the severity of governance vulnerabilities of its members – including corruption – and the macroeconomic impact of these vulnerabilities. Such an approach will also promote fairness, by ensuring that similarly situated member are treated similarly.

On April 6, 2018, the IMF's Executive Board adopted a Framework for Enhanced Fund engagement that is designed to address these issues. The new Framework consists of four elements and is designed to ensure that governance issues – and corruption in particular – are effectively addressed in all of the Fund's work.

The first element is designed to enable the Fund to assess the nature and severity of governance vulnerabilities—including corruption—on a systematic basis. This is achieved through an assessment of those state functions that are most relevant to economic activity; namely: (i) fiscal governance; (ii) financial sector oversight; (iii) central bank governance and operations; (iv) market regulation; (v) rule of law; and (vi) Anti-Money Laundering and Combatting the Financing of Terrorism (AML/CFT). While the sources of information to be relied upon to make this assessment will evolve, the Framework sets forth principles that will guide both the selection and use of information. Corruption would also be assessed based on the same principles, with a recognition that, given its particularly harmful impact on the economy, it is imperative that it be addressed specifically and forthrightly by the Fund when it is judged sufficiently severe to be macro-critical.

The second element will guide the Fund's assessment of the economic impact of the governance vulnerabilities that have been identified, taking into account, in particular, the applicable standards for IMF surveillance and the use of Fund resources (under the Guidelines on Conditionality). With respect to surveillance, in light of the evidence of the long-term impact of governance vulnerabilities, a determination as to whether these vulnerabilities are relevant to surveillance will be based on an assessment of their severity, irrespective of whether there is evidence of their short-term impact on the economy. For purposes of determining whether reforms to address governance vulnerabilities should be a condition for the use of the Fund's resources, the Fund will assess whether addressing these vulnerabilities is of critical importance for achieving the goals of the member's program.

The third element will shape the policy recommendations provided by the Fund, which will be informed by the diagnosis of the vulnerabilities, be candid and discussed with authorities, whose views should be accurately reflected in staff reports. In those areas that are outside the Fund's area of competence, the Fund will rely on the expertise of other international institutions, particularly the World Bank. Where corruption is assessed as severe, the approach would rely on a multi-pronged strategy that promotes not only specific anti-corruption measures but also broader regulatory and institutional reforms, taking into consideration the circumstances of the member.

The fourth element will involve an assessment of governmental measures to prevent private actors from offering bribes or providing services that enable the proceeds of corrupt acts to be concealed, particularly in the transnational context. More specifically, irrespective of whether a member country is experiencing severe corruption, the Fund would urge the member to volunteer to have its own legal and institutional frameworks assessed in the context of bilateral surveillance for purposes of determining whether: (a) it criminalizes and prosecutes the bribery of foreign public officials; and (b) whether it has an effective AML/CFT system designed to prevent foreign officials from concealing the proceeds of corruption—both of which address the transnational facilitation of corruption.

Implementation will be a challenge. Conducting open and frank discussions of these issues with government officials is difficult. But the alternative – ignoring the problem – is not a viable one, given the impact that these issues can have on the IMF's ability to fulfill its mission.

IV. Regulatory Developments Related to the European Banking Union (2016-2018)

A. Introductory Remarks

1. The European Banking Union (EBU) is a by-product of the political decisions made in 2012, which provided for the establishment of a Single Supervision Mechanism (SSM), a Single Resolution Mechanism (SRM) and a Single Resolution Fund (SRF), as well as a European Deposit Insurance Scheme (EDIS), transferring thus (basically within the institutional framework set by the EU Treaties), considerable powers from Member States to EU institutions and agencies. These three pillars should be coupled by a single rulebook governing the prudential regulation, supervision and resolution of (mainly) credit institutions, as well as bank deposit guarantee schemes. The related (comprehensive) legal framework was almost completed by mid-2014, with the adoption of two EU Regulations governing the operation of the SSM and the SRM/SRF (SSMR and SRMR, respectively), one Regulation on bank prudential regulation (CRR) and three Directives: on other aspects of bank prudential regulation and on bank supervision (CRD IV), on bank resolution (BRRD) and on deposit guarantee schemes (DGSD). The only exception is the establishment of EDIS, which is still pending.

2. The SSM and the SRM are already in full operation (since November 2014 and January 2016, respectively) and have already produced a significant bulk of work. Since June 2017, the conditions for resolution under the SRMR (Article 18) have been tested in four (4) cases and have led to differentiated assessments and decisions by the Single Resolution Board (SRB, an EU agency which constitutes the hub within the SRM, like the ECB within the SSM). In particular, on 7 June 2017 the SRB has taken resolution action in respect of Banco Popular Español, after having assessed that the conditions for resolution under the SRMR were met. On the other hand, on 23 June 2017 it decided not to take resolution action in respect of two Italian credit institutions, namely Banca Popolare di Vicenza S.p.A. and Veneto Banca S.p.A., assessing that the public interest criterion (i.e., the third condition for resolution) was not met due to the particular characteristics of these credit institutions and their specific financial and economic situation, and should hence be wound-up. On 24 February 2018, it decided on the same course of action with regard to the Latvian ABLV Bank and its subsidiary ABLV Bank Luxembourg.

3. The legal framework governing the EBU and (mainly) the underlying single rulebook is currently under (partial) amendment with a view to its enhancement. The related legislative developments can be viewed through the lens of three benchmark Commission initiatives (see below, under B-D, respectively):

B. The 'Legislative Banking Package' (November 2016)

The so-called 'legislative banking package' of the European Commission of 23 November 2016 was tabled on the basis of its Communication of 24 November 2015 "Towards the completion of the Banking Union". It concerns the amendment of several aspects of the SRMR, the BRRD, the CRR and the CRD IV (with a view to reducing risks in the financial system and further strengthening the resilience of EU credit institutions):

1. The amendments to the CRR refer to the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties and to collective investment undertakings, large exposures, as well as reporting and disclosure requirements and those to the CRD IV to exempted entities, financial holding companies and mixed financial holding companies, remuneration, supervisory measures and powers, as well as capital conservation measures.

The vast majority of the proposed amendments is broadly based on aspects of the so-called "Basel III regulatory framework" of the Basel Committee on Banking Supervision, which were not included in these EU legal acts at the time of their adoption (in 2013).

2. The package also contained a Proposal for a Directive of the European Parliament and of the Council "amending [the BRRD] as regards the ranking of unsecured debt instruments in insolvency hierarchy", which is its only element already completed. In accordance with Directive (EU) 2017/2399 of 12 December 2017, amending Article 108 BRRD on the ranking of unsecured debt instruments in insolvency hierarchy, Member States must (*inter alia*) ensure that, for credit institutions, ordinary unsecured claims resulting from debt instruments with the highest priority ranking among debt instruments in national law governing normal insolvency proceedings have a higher priority ranking than that of unsecured claims resulting from debt instruments meeting specific conditions.

3. Finally, a combined legislative proposal refers to the amendment of both the SRMR and the BRRD: the Proposal for a Regulation "amending the SRMR regards loss-absorbing and recapitalisation capacity for credit institutions and investment firms" and the Proposal for a Directive "amending the BRRD "on loss-absorbing and recapitalisation capacity of credit institutions and investment firms (…)" provide for the review of the minimum requirement for own funds and eligible liabilities (MREL), and the implementation in the EU legal framework of the total loss-absorbing capacity (TLAC) standard of the Financial Stability Board (FSB).

a. The application of MREL is governed by Articles 12 SRMR and 45 BRRD and by a related Commission Delegated Regulation [(EU) 2016/1450 of 23 May 2016]. This requirement was introduced in order to ensure that if resolution authorities decide to apply the bail-in instrument in the course of an institution's resolution there would be sufficient liabilities to absorb losses ('bail-inable instruments'). The MREL is calculated as the amount of 'own funds' and '*eligible* liabilities' of an institution, as a percentage of its own funds and *total* liabilities.

b. The framework governing TLAC is governed by the FSB Report of 9 November 2015 on "Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution – TLAC Term Sheet". These Principles and this Term Sheet lay down the 'minimum TLAC standard') for the thirty (30) banks identified by the FSB as global systemically important (G-SIBs),and introduce an 'internal TLAC standard', which refers to the loss-absorbing capacity that resolution entities have committed to 'material sub-groups' in order to facilitate co-operation between home and host authorities and the implementation of effective cross-border resolution strategies.

Even though the TLAC standard and the MREL pursue the same regulatory objective, there are some essential differences between them:

a. The MREL applies to the entire perimeter of EU credit institutions, while the application of the TLAC standard is confined to systemically important cross-border banking groups.

b. While the level of the MREL is determined by resolution authorities on a case-by-case basis institution specific assessment, the TLAC standard contains a harmonised minimum level.

c. Finally, for the purposes of the MREL, subordination of debt instruments could be required by resolution authorities on a case-by-case basis if necessary to ensure that in a given case bailed in creditors are not treated worse than in a hypothetical insolvency scenario. On the other hand, the minimum TLAC requirement should *in principle* be met with subordinated debt instruments.

In respect of this combined legislative proposal, it should be noted that, while the harmonised minimum level of the TLAC standard will be introduced in the EU through amendments to the CRR and the CRD IV, the 'institution specific add-on' for global systemically important institutions (G-SIIs) and the 'institution specific MREL' for non-G-SIIs are dealt with through amendments to the BRRD and the SRMR. In particular:

i. The objective of the proposal amending the BRRD is to implement the TLAC standard and to integrate the TLAC requirement into the general MREL rules by avoiding duplication which would arise from the application of two parallel requirements. Accordingly both requirements should be met

with largely similar instruments, requiring thus the introduction of limited adjustments to the existing MREL rules ensuring technical consistency with the requirements for G-SIIs laid down in Article 131 CRD IV. In addition, further appropriate technical amendments to the existing rules on MREL are proposed to align them with the TLAC standard as regards, *inter alia*, the denominators used for measuring loss-absorbing capacity, the interaction with capital buffer requirements and risk disclosure to investors.

That legislative proposal also amends the BRRD with a view to reduce compliance costs of EU credit institutions where their liabilities are governed by the laws of third countries. In addition, in order to enable resolution authorities to contribute to the stabilisation of a credit institution in the period before (and possibly after) resolution, it also introduces the application by these authorities of harmonised 'moratorium tools' in the course of resolution, meaning powers to suspend the execution of credit institutions' commitments towards third parties (including the repayment of deposits not covered by national deposit guarantee schemes under Article 6 DGSD, i.e., exceeding 100,000 euros *per* depositor *per* credit institution).

ii. The proposed amendments to the SRMR provide that the SRB and the national resolution authorities - members of the SRM must take into account the TLAC standard when setting and implementing the requirements on loss absorbing and recapitalisation capacity of entities established in those Member States.

C. The Commission Communication on "Completing the Banking Union" (October 2017)

1. On 11 October 2017, the Commission Communication "on completing the Banking Union" was published, which was broadly based on the conclusions of its Reflection Paper of 31 May 2017 "on the deepening of the economic and monetary union". This Communication laid down six (6) priorities, categorised in two (2) groups. The *first* group contains four (4) 'risk reduction' measures: finalisation of the above legislative banking package, undertaking of actions to address non-performing loans in accordance with the related Council Action Plan of July 2017, creation of sovereign bond-backed securities (see below, under (2)) and continuation of the attempt to ensure high quality supervision **(**under (3)).

The *second* group comprises two 'risk sharing' measures: the finalisation of the legislative process for the establishment of the EDIS (under (4)), and the creation of a 'common backstop', with regard to which the Commission submitted concrete proposals only two months later (this aspect is developed below, under (D)).

2. The creation of sovereign bond-backed securities (or sovereign-backed securities, the 'SBSs') is an aspect currently dealt with mainly by the ESRB. It is aiming at the reduction of systemic risk and the mitigation of financial fragmentation – and ultimately at the reduction of the 'bank-sovereign loop'. The first would be achieved by allowing credit institutions, insurance companies and other investors to diversify their government bond portfolios at relatively low transaction costs, and the second by allowing *all* participating Member States to contribute to the symmetrical supply of low-risk euro assets.

3. With regard to the aspect of increasing the quality of supervision, and notwithstanding its overall positive assessment of the work of the SSM with regard to the micro-prudential of credit institutions in the euro area, the Commission submitted on 20 September 2017 a Communication on "Reinforcing integrated supervision to strengthen Capital Markets Union and financial integration in a changing environment". This was coupled by four (4) Proposals for three (3) Regulations and one Directive of the European Parliament and of the Council for the amendment (*inter alia*) of the Regulations governing the "European Supervisory Authorities" (i.e. EBA, ESMA and EIOPA – ESAs) and the European Systemic Risk Board (ESRB). The objective of the proposed amendments to the ESAs' founding Regulations is to ensure stronger and more integrated financial supervision across the EU by improving their mandate, governance and funding.

In addition, there are proposals to enhance the micro-prudential supervision of investment firms, especially in view of the fact that, due to the existing potential for regulatory arbitrage, some large investment firms (usually a part of complex banking groups) provide investment banking services

which are outside the reach of the existing regulatory/supervisory framework and raise concerns of financial stability. Of particular institutional importance are also the proposals to develop the ESMA into a "Single Capital Markets Supervisor", by extending its direct supervision to selected capital market sectors, beyond those of credit rating agencies and trade repositories.

4. The progress on adopting the Regulation establishing the EDIS on the basis of a Commission's proposal of 2015 has been slow. In view of this development, the Commission identified in its EMU reflection paper the establishment of the EDIS (ideally by 2019, with a view to be in place and fully operational by 2025) as one of the key outstanding components for the EBU's completion. In this respect, in its above-mentioned Communication of 11 October 2017 concerning the completion of all parts of the EBU by 2018, the Commission submitted a compromise solution, proposing a more gradual introduction of the EDIS compared with the original proposal in only two (2) phases:

a. During the more limited 'reinsurance phase', the EDIS would only provide liquidity coverage to national DGSs, temporarily providing the means to ensure full payouts if a credit institution's deposits were to become unavailable. National DGSs would need to pay back this support, ensuring that any losses would continue to be covered at national level.

b. During the following 'coinsurance phase', the EDIS would also progressively cover losses. Nevertheless, the migration to this phase should be conditional on progress achieved in reducing risks.

D. The Commission Communication on "Completing the Economic and Monetary Union" (December 2017)

The priority character of the actions identified by the Commission in its October 2017 Communication was further reinforced in its Communication of 6 December 2017 "Further steps towards completing Europe's Economic and Monetary Union: A roadmap", which outlines a comprehensive package of six (6) proposals to strengthen the EMU. Of particular significance for the EBU is the Proposal for a Council Regulation "on the establishment of a European Monetary Fund", to be adopted on the basis of Article 352 TFEU. This proposal provides for the establishment of a European Monetary Fund (EMF), the Statute of which is set out in the Annex to the Regulation and forms an integral part thereof.

The objective of the EMF, which will succeed to and replace the European Stability Mechanism (ESM), should consist in contributing to financial stability in the euro area and in participating Member States. For the achievement of its objective, the EMF should be assigned two tasks, the second consisting in the provision of credit lines or setting guarantees in support of the SRB for the SRF (the 'common backstop').

V. Cross-Border Resolution

Following the financial crisis of 2007–2009 jurisdictions have initiated substantive reforms to facilitate the orderly resolution of failing financial institutions in a manner that preserves financial stability and does not expose taxpayers to the risk of loss. In 2011, the FSB adopted an international minimum standard for resolution ("The Key Attributes of Effective Resolution Regimes for Financial Institutions").[3] The standard seeks to promote the consistency of resolution regimes across jurisdictions and the cooperation and coordination that is needed to make cross-border resolution feasible and credible. Good progress has been made in implementing the Key Attributes. However, making resolution operational across borders is where work is still in progress. Contractual approaches can support cross-border effectiveness of resolution and help fill gaps in statutory regimes going forward.

[3] Financial Stability Board 2014. "The Key Attributes of Effective Resolution Regimes for Financial Institutions." 2011/2014. The 2014 document of the Key Attributes contains additional sector-specific guidance for insurers, financial market infrastructures, and the protection of client assets in resolution.

Single point of entry and total loss-absorbing capacity

For the largest cross-border banks that have been designated as 'global systemically important financial institutions (G-SIFIs)' by the FSB, authorities have in place an ongoing process of resolution planning and regular resolvability assessments undertaken within cross-border crisis management groups among the relevant home and key host authorities represented on those groups. The FSB's total loss-absorbing capacity (TLAC) standard is a pivotal component in the FSB's approach to cross-border resolution of G-SIFIs.[4] It seeks to make sure that all global systemically important banks (G-SIBs)[5] have in place at all times a minimum amount of financial resources that can be bailed in to achieve a creditor-financed restructuring that maintains the continuity of the firm's vital operations. Authorities have developed bail-in resolution strategies that contemplate entry into resolution of the top-tier parent of a financial group ("single point of entry"). The bail-in within resolution of TLAC located at the parent should generate sufficient loss-absorbing resources to recapitalize the firm's material subsidiaries, including foreign subsidiaries, so that they can either continue operating or be sold or wound down in an orderly fashion.

Home-host cooperation

Substantial work remains to make bail-in resolution operational across borders. To be effective it requires not only the powers and operational capacity to execute a bail-in, it also requires loss-absorbing ("bail-inable") resources in adequate amounts to be available where needed in a group to recapitalise critical operations of both domestic and foreign subsidiaries.

Financial crises have repeatedly illustrated the problems that can arise when local regulators seek to restrict fund transfers from the parent to the subsidiary or vice-versa, or impose asset maintenance requirements to secure local liabilities. To provide assurances to host authorities that loss-absorbing resources will be available to a material subsidiary of a foreign G-SIB in times of stress, the FSB's TLAC standard requires foreign subsidiaries or groups of subsidiaries that are deemed to be material to have on their balance sheet ("prepositioned") capital instruments or liabilities issued to the parent ("internal TLAC"). The write-down of internal TLAC would pass the losses to the parent's equity holders and its unsecured creditors without necessitating the subsidiary's entry into resolution. The prepositioning of internal TLAC should give confidence to host authorities that material subsidiary or subgroup has sufficient loss-absorbing and recapitalization capacity available to maintain the continuity of local material operations and should reduce the incentives for imposing ex post ring fencing in a crisis. However, excessive prepositioning of resources locally can also weaken the resilience of institutions. A balance needs to be found between providing adequate assurances to local authorities and supporting incentives for home-host cooperation.

Contractual approaches to support resolvability

So far, only a few institutions have been resolved using the procedures and tools provided for in the international resolution framework. None of the institutions that have been resolved using the tools has been a G-SIB. Given the uncertainty on how resolution powers will be applied in practice, in particular in a cross-border context authorities may be apprehensive about relying solely on their statutory powers. For purposes of resolution planning both authorities and firms tend to employ contractual approaches in addition to statutory mechanisms if available. For example the European Bank Recovery

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[4] Financial Stability Board. 2015. "Total Loss-Absorbing Capacity (TLAC) Principles and Term Sheet," November 9.

[5] *See* Financial Stability Board. 2011. "Policy measures to address systemically important financial institutions" November. In that publication, the FSB identified as global systemically important financial institutions (G-SIFIs) an initial group of G-SIBs, using a methodology developed by the BCBS. The list is updated annually based on new data and published by the FSB each November. In 2017, 30 banks were identified as G-SIBs as part of the annual identification process of G-SIFIs. *See* 2017 List of global systemically important banks (G-SIBs), November 21, 2017.

and Resolution Directive (BRRD)[6] requires firms to include contractual recognition clauses in debt instruments issued in other jurisdictions. Such clauses provide for consent by the holder of the instrument for bail-in by the relevant home resolution authority.[7] The contractual recognition approach has been widely adopted in relation to cross-border stays on termination clauses. The International Swaps and Derivatives Association (ISDA) has, in coordination with the FSB, developed protocols whereby the adhering parties contractually adopt provisions that limit the exercise of termination rights.[8] In jurisdictions where authorities (still) lack statutory powers to bail in creditors, contractual point of non-viability (PONV) securities tend to be the norm.[9] In the European Union, an amendment to the BRRD creates a new class of senior non-preferred debt that is junior to all senior liabilities, but senior to subordinated debt. As such it melds statutory and contractual approaches in that the subordination is effective only if, when issued, the instruments contain explicit language noting their 'non-preferred' senior ranking.[10] Internal TLAC triggers will need to be agreed contractually between the resolution entity and the material sub-group.[11] In the US, the Federal Reserve Board issued a rule that defined the terms that contractual internal TLAC instruments need to contain.[12] The FSB Guidance on operational continuity[13] states that firms should have clearly and comprehensively documented contractual arrangements and service level agreements for both intra-group and third party critical shared services which, to the greatest extent possible, remain valid and enforceable in resolution provided there is no default in payment obligations.

Contractual approaches are not a substitute for a robust statutory resolution framework and they are not a substitute for cross-border cooperation amongst public authorities. However, they can help

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[6] European Union. 2014. Directive 2014/59/EU of the European Parliament and of the Council of May 15, 2014, establishing a framework for the recovery and resolution of credit institutions and investment firms (known as BRRD) http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014L0059.

[7] Article 55 of the BRRD requires the inclusion in agreements "creating" an unsecured liability that are "governed by the law of a third country," a clause by which the "creditor or party to the agreement" recognizes that this liability may be subject to public authorities' write-down and conversion powers.

[8] International Swaps and Derivatives Association. 2015. "ISDA 2015 Universal Resolution Stay Protocol." Twenty-one global banks had adhered to the protocol in November 2015. Whereas the Universal Stay Protocol is aimed at sell-side institutions, the ISDA Resolution Stay Jurisdictional Modular Protocol offers an approach tailored to jurisdiction-specific regulatory requirements and is aimed at buy-side firms. *See* International Swaps and Derivatives Association. 2016. "ISDA Resolution Stay Jurisdictional Modular Protocol."

[9] *See* Sect. 14 of the TLAC Standard ("*Eligible external TLAC should contain a contractual trigger or be subject to a statutory mechanism which permits the relevant resolution authority to effectively write it down or convert it to equity in resolution*.").

[10] Directive (EU) 2017/2399 of the European Parliament and of the Council of 12 December 2017 amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy.

[11] *See* Sect. 19 of the TLAC Standard ("*Internal TLAC must be subject to write-down and/or conversion to equity by the relevant host authority at the point of non-viability, as determined by the host authority in line with the relevant legal framework, without entry of the subsidiary into statutory resolution proceedings*.").

[12] *See* Federal Register, November 30, 2016. "Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations," 12 CFR 252, https://www.federalregister.gov/documents/2015/11/30/2015-29740/total-loss-absorbing-capacity-long-term-debt-and-clean-holding-company-requirements-for-systemically.

[13] Financial Stability Board, Guidance on Arrangements to Support Operational Continuity in Resolution, 18 August 2016, *see* http://www.fsb.org/wp-content/uploads/Guidance-on-Arrangements-to-Support-Operational-Continuity-in-Resolution1.pdf.

strengthen the credibility of resolution by reinforcing authorities' self-commitment to not bailing out firms. Credible resolution strategies strengthen market discipline and provide incentives for counterparties to find a solution or achieve a work-out outside of resolution.

Looking ahead

The introduction of resolution regimes and resolution planning constitutes a sea change in the handling of financial failures. Ten years ago no one would have expected such far-reaching changes. However, political will to make far reaching changes wanes as the memory of crisis fades. Girding the arrangements that have been put in place and developing them further is essential for enhancing market discipline and reducing the risk of disorderly failure.

VI. The Emerging International Law of Sovereign Debt Restructuring – Recent Developments

A. Introductory remarks

Previous MOCOMILA reports have explored the peculiarities of sovereign debt restricting (SDR) and lessons that can be gleaned from sovereign debt crises.[14] They have also been the occasion to provide an update on the work of the ILA Sovereign Bankruptcy Group which has focused, among other things, on the debate "contractual versus statutory approach" when it comes to addressing sovereign insolvencies.[15] While building on these contributions, the purpose of this section is to identify current trends of what may be designated as the emerging international law of SDR. In the absence of a fully-fledged international mechanism dealing with sovereign insolvencies, specific attention needs to be paid to recent initiatives aiming to facilitate restructuring processes and to prevent or limit negative collateral effects of sovereign debt litigation involving holdout creditors. These initiatives are characterized by their decentralized dimension and the diversity of their promoters (states, regional and international organizations, private professional associations, etc.) as well as the nature of the instruments on which they rely (domestic statutes, treaties, soft-law instruments, etc.). Haphazardly developed without an overarching strategy, they shape, however, the future of the emerging SDR discipline.

After a short overview of the different types of legal claims arising out of or in connection with SDRs involving holdout creditors (B), we will point out initiatives to restrict sovereign debt litigation at various stages of the proceedings (C) and, more specifically, recent developments relevant to sovereign debt in the field of contract standardization (C)(1), the attempts to neutralize the investor/State dispute settlement option in sovereign debt litigation (C)(2) and, lastly, initiatives to block holdout strategies through anti-vulture fund laws and rules on immunity from execution (C)(3).

B. A mapping of sovereign debt litigation involving holdout creditors

Recent SDRs, especially in the Argentinean and Greek cases, gave rise to an impressive number of disputes showing the variety of litigation strategies that may be deployed in such situations. Without any claim to completeness, the following offers an overview of the different categories of disputes.

1. Litigation initiated by holdout bondholders following the default of payment

- with forum selection clause and waiver of immunity from jurisdiction;[16]
- without forum selection clause and waiver of immunity from jurisdiction.[17]

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[14] MOCOMILA, Sofia Conference Report, 2012, p. 5-8.

[15] MOCOMILA, Washington Conference Report, 2014 p. 5-8. *See also*, ILA Sovereign Bankruptcy Study Group, Johannesburg Conference Report, 2016, p.21.

[16] For instance: *Lightwater Corp. Ltd. et al. v. Republic of Argentina*, *Lightwater Corp. Ltd. et al. v. Republic of Argentina* (S.D.N.Y. 14 April 2003); BVerfG, Beschluss des Zweiten Senats vom 08. Mai 2007, 2 BvM 1/03 - Rn. (1-95).

2. Litigation initiated by holdout bondholders for breach of the *pari passu* clause following payments made on restructured bonds[18]

3. Litigation between holdout bondholders and the debtor State for a sovereign decision affecting contractual rights (moratorium on payments, retroactive insertion of CACs, etc.)

- before the domestic courts of the debtor State;[19]
- before the European Court of Human Rights (ECtHR) after the exhaustion of local remedies;[20]
- before investment arbitral tribunals.[21]

4. Litigation before the Court of Justice of the European Union (CJEU) regarding the extracontractual liability of the European Central Bank for its role in the Greek debt restructuring and its preferential creditor status[22]

5. Litigation related to measures of enforcement requested by holdout bondholders

- Litigation before domestic courts:
  - (a) against the assets of the debtor State;[23]
  - (b) against the assets of the debtor State in the hands of garnishees;[24]
  - (c) against the assets of a territorial subdivision of the debtor State (for instance, an Argentinean province);[25]
  - (d) related to discovery requests to determine the location of the debtor State assets.[26]
- Interstate litigation initiated by the debtor State against a State whose courts have approved the seizure of the debtor State assets;[27]

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[17] For instance: BGH, 8 March 2016, *Fahnenbrock e.a. v. Greece*, No. VI ZE 516/14.

[18] For instance: *NML Capital, Ltd. v. Republic of Argentina*, 727 F.3d 230 (2d Cir. 2013).

[19] For instance: Hellenic Council of State, 21 March 2014, No. 1116/2014 and 1117/2014.

[20] ECtHR, 21 July 2016, No. 63066/14, 64297/14, 66106/14, *Mamatas e.a. v. Greece*.

[21] For instance: *Abaclat and Others v. Argentine Republic*, ICSID Case No. ARB/07/5; *Ambiente Ufficio S.p.A. and others v. Argentine Republic*, ICSID Case No. ARB/08/9; *Giovanni Alemanni and Others v. The Argentine Republic*, ICSID Case No. ARB/07/8; *Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic*, ICSID Case No. ARB/13/8.

[22] *Alessandro Accortini and others v. ECB*, T-79/13, Judgment of 7 October 2015; *Nausicaa Anadyomène SAS and Banque d'escompte v. ECB*, T‑749/15, Judgment of 24 January 2017.

[23] For instance, in the US (*EM Ltd. v. Banco Central de la República Argentina*, 800 F.3d 78, 99 (2d Cir. 2015)), in the UK (*NML Capital Ltd v Republic of Argentina*, [2011] UKSC 31) and in France (Civ. 1ère, 28 September 2011, n° 09-72.057, *NML v. Argentina*).

[24] For instance, in France: Civ. 1ère, 28 March 2013, n° 10-25.938, 11-10.450 et 11-13.323, *NML v. Argentina, Total Austral and Air France*.

[25] For instance, in France: Cass. 2ème civ., 4 September 2014, n° 13-14.060, *NML v. Provincia del Chubut.*

[26] *Republic of Argentina v. NML Capital, Ltd.*, 134 S. Ct. 2250 (2014).

[27] ITLoS, *Ara Libertad (Argentina v. Ghana)*, No. 20, Order of 15 December 2012.

- Litigation initiated by a creditor before the ECtHR against a State whose courts have refused the seizure of the debtor assets because of immunity of execution.[28]

C. Initiatives to restrict sovereign debt litigation involving holdout creditors

Following the difficulties encountered in sovereign debt litigation affecting to a large extent orderly restructuring processes, several initiatives have been taken by States, international organizations and private actors. Interestingly, most of them aim to provide an effective response to the problems stemming from the aforementioned different types of sovereign debt litigation. To a certain extent, they also echo some of the nine *Basic Principles on Sovereign Debt Restructuring Processes* identified by the UN General Assembly resolution 63/319 adopted in September 2015 (right of the State to restructure its sovereign debt, good faith, transparency, impartiality, equitable treatment, sovereign immunity, legitimacy, sustainability, majority restructuring). It should be noted that Canada, Germany, Japan, the United Kingdom, and the United States voted against and it is therefore unlikely that this resolution fully reflects international customary law.

1. Neutralizing holdout strategies based on contractual claims *(cf B.1. and B.2.)* through contract standardization

The absence of collective action clauses (CACs) in sovereign bonds that gave rise to holdout litigation was a similar feature of the Argentine and Greek crises (in the latter case, CACs were eventually retroactively inserted through a domestic statute given that bonds were governed by Greek law). The (questionable or at least too literal) interpretation given to the *pari passu* clause by New York courts in the Argentine case has generated considerable uncertainty for future SDRs. It is thus not a surprise that, with the participation of relevant stakeholders, the International Capital Market Association (ICMA) has undertaken in 2014-2015 a revision of its model collective action and *pari passu* clauses.[29] CACs have been common market practice in corporate bonds since the end of the XIXth century and the practice of CACs has started to become widespread in New York after 2003. ICMA's objective was therefore less to ensure a broader dissemination of CACs than to respond to new challenges of SDRs. The new ICMA model CAC includes aggregation mechanisms so as to trigger collective action mechanisms across multiple series of bonds and to lower the risk of blocking position. The new *pari passu* model clause has been clarified so as to explicitly exclude the obligation to effect ratable payments and limit the risk of an interpretation similar to the one given by New York courts in the Argentinean litigation. The IMF endorsed the inclusion of such enhanced clauses in new international sovereign bonds and has published every year a *Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts*. It noted in its last December 2017 report that only a few issues continue not to incorporate the enhanced CACs (Lebanon, Korea and the Philippines under New York law; Azerbaijan, Hungary, Malaysia and Poland under English law; Hungary under Chinese law; Indonesia under Japanese law).[30]

With respect to the Euro area, it must be noted that a model CAC is mandatory in all "euro area government securities, with maturity above one year" pursuant to article 12§3 of the Treaty establishing the European Stability Mechanism (ESM). It constitutes an interesting example of how a treaty can be used as a medium to promote a contractual approach.

2. Neutralizing the investor/State dispute settlement (ISDS) option *(cf B.3.)*

Claims lodged before the domestic courts of the debtor State, the CJEU and the ECtHR (B.3. and B.4.) were eventually unsuccessful for holdout creditors. These courts have recognized (or to the ECB for the CJEU) a wide margin of appreciation for States when it comes to implementing measures aimed at

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[28] ECtHR, 13 January 2015, No. 23242/12, *NML v. France*.

[29] <https://www.icmagroup.org/resources/Sovereign-Debt-Information>.

[30] <http://www.imf.org/~/media/Files/Publications/PP/2017/pp113017third-progress-report-on-cacs.ashx>.

safeguarding financial stability.[31] Moreover, it must be noted that these (in fact quite trivial in substance) procedures of judicial review of administrative decisions have not, as such, threatened the Greek SDR. The same cannot be said concerning investment arbitration proceedings involving Argentina and Greece which eventually ended in 2016. The *Abaclat* claim involving Argentina was terminated following the conclusion of a settlement agreement with the holdout creditors.[32] The *Poštová banka* claim involving Greece was dismissed at the jurisdictional stage and annulment proceedings were unsuccessful for the creditor.[33] These cases gave rise to intense debates as to whether sovereign debt should qualify as a protected investment under a bilateral investment treaty (BIT) and/or article 25 of the ICSID Convention. While we could have endless discussions on this issue, there is a clear trend that certain States have decided to neutralize the ISDS option in their treaty practice. It is for instance the case of the Comprehensive and Economic Trade Agreement (CETA) concluded in 2016 between Canada and the EU as well as its member States. The following provisions of CETA rejects the admissibility of an investment claim related to a SDR which has been defined in a way which has a particular resonance in the line of the Greek SDR:

CETA, Article 8.18.5
A claim with respect to restructuring of debt issued by a Party may only be submitted under this Section in accordance with Annex 8-B.

CETA, Annex 8.B
1. For the purposes of this Annex: **negotiated restructuring** means the restructuring or rescheduling of debt of a Party that has been effected through

(a) a modification or amendment of debt instruments, as provided for under their terms, including their governing law, or
(b) a debt exchange or other similar process in which the holders of no less than 75 per cent of the aggregate principal amount of the outstanding debt subject to restructuring have consented to such debt exchange or other process;
and governing law of a debt instrument means a jurisdiction's laws applicable to that debt instrument.

2. **No claim that a restructuring of debt of a Party breaches an obligation** under Sections C and D may be submitted, or if already submitted continue, under Section F if the restructuring is a negotiated restructuring at the time of submission, or becomes a negotiated restructuring after such submission, except for a claim that the restructuring violates Article 8.6 [*national treatment*] or 8.7 [*most favoured nation treatment*].
(…)

It can also be noted that the *UN Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights* has adopted a critical stance with regard to ISDS and recommended in its July 2017 report that "international investment agreements should exclude investment claims related to debt restructuring disputes".[34]

3. Blocking holdout strategies through anti-vulture fund laws and rules on immunity from execution *(cf B.5.)*

[31] *See* for instance: *Nausicaa Anadyomène SAS and Banque d'escompte v. ECB*, T-749/15, Judgment of 24 January 2017, § 121; ECtHR, 21 July 2016, No. 63066/14, 64297/14, 66106/14, *Mamatas e.a. v. Greece*, § 84 *et seq*.

[32] *Abaclat and Others v. Argentine Republic*, ICSID Case No. ARB/07/5, Consent Award, 29 December 2016.

[33] *Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic*, ICSID Case No. ARB/13/8, Decision on *Poštová banka's* application for partial annulment of the Award, 29 September 2016.

[34] *Effects of foreign debt and other related financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights*, A/72/153, 17 July 2017, § 69.

Certain States have adopted so-called "anti-vulture funds" laws which place a cap on the amount that recalcitrant creditors may recover in courts depending on a number of criteria varying from one country to another. For instance, eligible debt under the UK Debt Relief (Developing Countries) Act of 2010 is limited to the debt of about forty countries qualifying for the World Bank and IMF HIPC initiative. Under the 2015 Belgium anti-vulture funds statute, the law introduces the concept of "illegitimate advantage" that is characterized when (1) there is a manifest difference between the purchase price and the sums claimed by the creditors and (2) one another criterion is met (among them, the fact that the debtor State is in actual or imminent state of insolvency).[35] The French "anti-vulture funds" law adopted in December 2016 rests on another discipline (eligible countries are those identified by the Development Assistance Committee of the OECD, situation of default of less than 48 months, etc.)[36] and is strictly limited to the prohibition of enforcement measures for creditors not meeting these standards.

More broadly, rules concerning immunity from execution could be interpreted in a very restrictive way in order to block enforcement sought by holdout creditors. It was for instance the case in France and in Belgium where supreme courts did not give full effect to the waiver of immunity from execution included in Argentinean bonds. These restrictive standards have been subsequently included in new domestic statutes adopted by two countries in 2015 and 2016 which also added a condition of prior judicial authorization for any measure of enforcement.[37] This is in line with the UNGA *Basic Principles on Sovereign Debt Restructuring Processes* which provide that "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" (Principle 9). This raises the question as to whether combatting holdout creditors does not cause collateral damage to the extent that it has led some States to rewrite their rules of sovereign immunity from execution that are eventually applicable to all enforcement measures, including those related to other types of liabilities such as arbitral awards, damages for torts or compensation to be paid to embassy employees.

VII. Recent Developments in Sovereign Debt Restructuring

MOCOMILA last reported on sovereign debt issues at the ILA's 2014 Washington Conference, where MOCOMILA also sponsored a debate between two teams on the topic of sovereign debt resolution methods: one team argued in favour of a treaty-based approach to sovereign debt restructuring and the other argued for contractual resolutions. This note will provide an update on recent developments in sovereign debt restructuring including a proposal for a Model Law on sovereign debt restructuring.

Background

Historically, there have been two approaches to addressing sovereign debt restructuring. The "treaty approach" proposes to address sovereign debt issues by way of an international treaty or statute. Potential options for such a model vary significantly, from a full Chapter 11-style approach to sovereign debt to more moderate approaches that would effectively replicate the function of domestic bankruptcy statutes, including supermajority creditor control provisions. The IMF's 2002 proposed Sovereign Debt Restructuring Mechanism (**SDRM**) was an ambitious attempt to tackle sovereign debt through treaty that sought to amend the IMF's Articles of Agreement.[38] This ambitious approach contributed to the proposal's downfall, as both the original version and a later reworked attempt failed, and there continues to be little support for a treaty-style approach.

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[35] Loi relative à la lutte contre les activités des fonds vautours, Loi du 12 juillet 2015, n° 2015003318.

[36] Article 60 of the *Law n° 2016-1691 relative à la transparence, à la lutte contre la corruption et à la modernisation de la vie économique*, 9 December 2016.

[37] For Belgium: Code judiciaire, article 1412*quinquies*. For France, Code des procédures civiles d'exécution, articles L.111-1-1 to L.111-1-3.

[38] For the definitive account, *see* Sean Hagan, "Designing A Legal Framework to Restructure Sovereign Debt," 36 Geo. J. Int'l L. 299 (2004-2005).

The "contractual approach" foregoes international treaties in favour of a network of contractual devices, including collective action clauses (**CACs**), contained in sovereign bonds. A CAC is a contractual provision that allows a supermajority of bondholders to confirm a debt restructuring for all bondholders, regardless of whether those bondholders voted in favour of the restructuring. This addresses concerns of inter-creditor coordination and the need for unanimity when completing a debt restructuring. CACs may also address concerns about holdout creditors who would wield inordinate power over a debt restructuring, securing the best possible deal for themselves on the collective backs of all other creditors. A CAC supermajority addresses these concerns by presenting a more egalitarian approach to debt restructuring.[39] CACs have met with some success in managing sovereign debt restructurings and addressing concerns about holdout creditors.

Argentina and Greek Debt Crises

One of the most publicized recent examples of ongoing litigation relates to Argentina's sovereign debt crisis. The proceedings finally came to a halt in June 2014, when the US Supreme Court refused to hear Argentina's appeal of a lower court's decision issuing an injunction that prohibited Argentina from making payments on its restructured bonds without first paying holdout creditors in full. The Argentine litigation demonstrates not only the lasting and significant impact of sovereign debt issues on global markets, but also demonstrates the inordinate power and subsequent impact that may be wielded by a relatively small number of holdout creditors in a sovereign debt restructuring.[40]

The ongoing debt crisis in Greece further illustrates the problem of holdout creditors.[41] The 2012 Greek debt exchange was the largest-ever debt restructuring in the history of sovereign defaults, and ultimately allowed for €106 billion in debt relief (or approximately 55% of Greek GDP).[42] Crucially, though the domestic bond restructuring was executed relatively easily, holdout creditors were able to build blocking positions in more than half the series, resulting in a failed restructuring vote.[43] The challenges of the Greek debt crisis demonstrate that CACs, while certainly useful in addressing holdout creditors, do have their limits.

Venezuela and Ukraine

The recent well-documented financial concerns in Greece and Argentina may be fading, at least for now, but more recent developments in Venezuela and Ukraine continue to demonstrate the economic impact of a debt crisis, both domestically and internationally, and that such crises show little likelihood of diminishing on their own.

Holdout creditors continue to pose a threat to financial stability in the realm of sovereign debt restructuring. Today, Venezuela is in the midst of an economic crisis and a restructuring of the bonds issued by Venezuela's national oil company PDVSA seems likely. The PDVSA bonds lack any conditions permitting a supermajority of bondholders to approve a restructuring, thereby opening the door to holdout creditors looking to extract the best possible outcome for themselves.[44]

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[39] James Haley, "Sovereign Debt Restructuring: Bargaining for Resolution," *Centre for International Governance Innovation*, Papers No. 124 (April 2017).

[40] Lee Buchheit & Mitu Gulati, "Restructuring Sovereign Debt After NML v. Argentina," 12 Capital Markets Law Journal 224-238 (2017) Available at: https://scholarship.law.duke.edu/faculty_scholarship/3647.

[41] Lee Buchheit & Mitu Gulati, "Sovereign Debt Restructuring in Europe," Duke Law School Public Law & Legal Theory Series No. 2017-49. Available at SSRN: https://ssrn.com/abstract=3005039.

[42] Miranda Zafa, "Sovereign Debt Crisis Management: Lessons from the 2012 Greek Debt Restructuring," *Centre for International Governance Innovation*, Papers No. 33 (June 2014), p. 5.

[43] Jeromin Zettelmeyer, Christoph Trebesch, Mitu Gulati, "The Greek Debt Restructuring: An Autopsy," *Economic Policy*, 28:75, 513-563 (2013), p. 527.

[44] Buchheit and Gulati, "How to Restructure Venezuelan Debt" (July 21, 2017). Duke Law School Public Law & Legal Theory Series No. 2017-52. Available at SSRN:

Similarly, developing debt issues between Russia and Ukraine add further urgency to calls for a solution to sovereign debt restructuring. The issue relates to US$3 billion in Ukrainian bonds owned by Russia, and Ukraine's last-minute moratorium blocking the planned repayment of these bonds as part of its sovereign debt restructuring. The matter proceeded to litigation in England in January 2017, where Ukraine unsuccessfully raised a number of defences to claims for payment. In its judgment, the court noted the unique geopolitical situation of the matter, with the parties contending over debt instruments against a backdrop of Russian military action in Crimea and eastern Ukraine.[45] The court ultimately found against Ukraine; an appeal was heard in January 2018 with judgment pending.

Status of Current Efforts to Address Sovereign Debt

The ILA's Sovereign Insolvency Study Group

An ILA Study Group on sovereign insolvency was first formed in 2008 to study existing legal frameworks and to propose a broad range of policy options, without regard for political feasibility. The Study Group reported in August 2010 detailing four policy options, without making any recommendations: (1) leave restructuring to be determined by the markets, such as through CACs; (2) introduce a limited provision for creditor voting with a stay on creditor as voted on by creditors; (3) a full bankruptcy treaty regime, such as may be feasible; and (4) reduce protections available to sovereign states.

The Group was re-formed in 2012 at the ILA's 75th World Conference in Sofia, Bulgaria, to explore treaty-based and contract-based approaches to resolving sovereign debt issues under the leadership of Philip Wood, of Allen & Overy. In 2016, the Study Group submitted a note to the ILA's Johannesburg Conference that set out a brief history of sovereign debt restructuring, and then described the differences between the treaty and contractual approaches to sovereign debt restructuring.

Following this report the Study Group was reconstituted under the Chairmanship of Professor Michael Waibel, of Cambridge University, as the Study Group on Sovereign Bankruptcy. In September 2017, the Study Group held a workshop at the Lauterpacht Centre for International Law at Cambridge University. The workshop featured a variety of paper presentations and discussion, including: priorities in sovereign distress scenarios; developments on Ukrainian sovereign debt; challenges to sovereign debt restructurings; term sheets for GDP-linked bonds; and a proposal for an international centre for the financial safeguard of states. The workshop closed with a discussion of the Study Group's future work.

United Nations General Assembly

Recognizing the seriousness and intractability of sovereign debt issues following the Argentine default and subsequent litigation, the UN General Assembly established the Ad Hoc Committee on Sovereign Debt Restructuring Processes in 2014. The Committee, following a highly ambitious start, concluded by issuing Basic Principles on Sovereign Debt Restructuring[46] (the **Principles**), which encouraged adherence to principles such as good faith and impartiality in the context of debt restructuring. The Principles were endorsed by the General Assembly in 2015,[47] but were not supported by most developed economies, including the United States, Japan, and the European Union, as well as the IMF

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https://ssrn.com/abstract=3006680; Buchheit and Gulati, "The Coming Need for a Standstill in Venezuela, Financial Times, Oct. 10, 2017, https://ftalphaville.ft.com/2017/10/10/2194628/buchheit-and-gulati-the-coming-need-for-a-standstill-in-venezuela/.

[45] *The Law Debenture Trust Corporation PLC v Ukraine*, [2017] EWHC 655 (Comm) (UK), at paras. 257, 369-370.

[46] http://unctad.org/meetings/en/SessionalDocuments/a69L84_en.pdf.

[47] UNGA, Sixty-Ninth Session, 10 September 2015, adopted with 136 member States voting for, six against and 41 abstentions.

and the World Bank. Much like the SDRM in the early 2000s, the Principles failed to secure broad public support or concern, despite decades of grappling with sovereign debt issues.

"Second-wave" CACs

The shortcomings in CACs have been addressed in a so-called "second wave" of CACs. "Aggregated" CACs require a majority of all "aggregated" bondholders, as well as a slightly lower-threshold majority within each series of bonds, to consent to a restructuring. However, this still permits a relatively small portion of total creditors to block a restructuring, thus representing a marginal, though welcome, improvement over a traditional CAC. All bonds issued by Eurozone member states after January 1, 2013 with maturities greater than one year include a mandatory aggregated CAC, referred to as the "Euro Area Model CAC."[48]

In 2013, the International Capital Market Association (ICMA) developed a "single limb" CAC: aggregated CACs would hold a single vote across all series, theoretically increasing the predictability and speed of a restructuring. In October 2014, Kazakhstan became the first sovereign to sell bonds that contained a single limb CAC; Mexico, along with various issuers in Southeast Asia and Sub-Saharan Africa, soon followed suit.[49]

IMF Recommendations on CACs

In 2014, the IMF released a staff report examining ways to enhance the contractual approach to sovereign debt crises. The report first addressed the shortcomings of the *pari passu* clauses found in many debt instruments, and which proved to be so problematic in the Argentina litigation. The IMF report recommended revising new *pari passu* clauses, drafted so as to exclude the obligation to effect ratable payments. With very few exceptions, all recent issuances that have included enhanced CACs also included modified pari passu provisions.

The report also discussed the advantages of enhanced second wave CACs as robust and effective methods of addressing issues of holdout creditors, while also addressing potential creditor concerns relating to financial returns and the potential for sovereign manipulation. The report acknowledged that CACs have their limitations; that while they have shown promise, they could not fully eliminate the challenges of holdout creditors. Ultimately, the IMF endorsed the use of single limb CACs as the most effective method to managing sovereign debt crises.[50] Subsequent IMF reports have detailed the progress of second wave CAC incorporation globally; these reports suggest that the single limb approach detailed above may be the preferred global model.

Lending Into Arrears Policy

The IMF's lending into arrears (**LIA**) policy, originally introduced in 1989, also plays a very important role in sovereign debt management. The LIA policy sets aside the IMF's usual non-toleration policy with respect to private creditors such as banks, permitting continued IMF funding for a sovereign debtor. However, the LIA policy maintains non-toleration for arrears owed to official bilateral and multilateral creditors. This effectively removes a private creditor's veto power – or more accurately, the motivation to exercise any veto power – in relation to a debt restructuring, and allows IMF oversight of subsequent financing and purchases, encouraging timely and orderly debt repayment. Amendments to the LIA policy in the late 1990s expanded the scope of permissible arrears to include

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[48] Collective Action Clauses in Euro Area, *Europa* (website), archived August 11, 2014, available online: https://web.archive.org/web/20140811165017/http://europa.eu/efc/sub_committee/cac/index_en.htm.

[49] International Monetary Fund, *Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring*, October 2014, https://www.imf.org/external/np/pp/eng/2014/090214.pdf.

[50] *Id.*

international sovereign bonds, and introduced the requirement that the member and its creditor must be engaged in genuine good faith negotiations to resolve the debt issues.[51]

Official creditors' preferential position – the effective preservation of their veto power over restructuring – was justified because of their role in global finance. Bilateral creditors are generally more willing than private creditors to enter into agreements with debtors, and official creditors typically do not provide financial support to make profit, as private creditors do, but rather for public policy reasons. Similarly, official creditor financing may meet or even exceed IMF funding, provided a crucial source of capital to sovereign debtors. As a result, official creditors feel that they should enjoy a preferred debt treatment and more leverage over debtors during a restructuring, and the LIA policy has traditionally sought to minimize arrears owed to official creditors.[52]

A 2015 LIA policy revision addressed the issue of non-toleration of official creditor arrears owed to official creditors, as such treatment effectively preserved their veto power over restructurings. The revision permitted lending into official arrears if the sole reason for those arrears was the official creditor's unwillingness to conform to the parameters of the IMF-supported program. The IMF would also have to determine that LIA would not have any undue negative effect on the IMF's ability to respond to similar situations in the future. This revision expanded the scope of IMF intervention in sovereign debt crises, and challenged official creditors' preferential treatment as an unreasonable burden on sovereign debt restructuring. More than that, it signals a new direction in international economic policy. Having learned from previous holdout creditor litigation, it seems that debt management policies may begin shifting, moving against entities that resemble or have characteristics of a holdout creditor.[53]

A Model Law Proposal

The treaty approach to debt restructuring has proven politically infeasible, and contractual reforms provide an incomplete or only partial success in addressing the issue. Though recent developments, such as the revised LIA policy or the advent of second wave CACs, are useful in many ways, including addressing issues of holdout creditors, they all ultimately fall short of the goal of providing a comprehensive, egalitarian, and predictable framework for managing sovereign debt restructuring. With the continuing uncertainty surrounding sovereign debt crises, and the potential for financial instability that goes with it hand-in-hand, a possible middle way has been proposed that may offer a more effective solution to sovereign debt restructuring. That proposal is a Model Law on sovereign debt restructuring.

A Model Law approach[54] has been around for some time,[55] but has more recently been taken up by the Centre for International Governance Innovation (**CIGI**) and is currently being promoted with two governments. This approach attempts to bridge the gap between contractual provisions and a true treaty regime. Unlike CACs, the Model Law would apply to all payment claims, rather than just bonded debt, and would also apply to bilateral (country-to-country), bank, and syndicated loans.[56] The

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[51] International Monetary Fund, *Fund Policy on Lending into Arrears to Private Creditors – Further Consideration of the Good Faith Criterion*, July 30, 2002.

[52] International Monetary Fund, *Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors*, IMF Policy Paper, December 2015.

[53] *Id.*

[54] Steven L. Schwarcz, "Sovereign Debt Restructuring: A Model-Law Approach" (2015) 6:23, *J Globalization & Dev*, 343. Schwarcz's article also includes a proposed Model Law, which will be referenced in these footnotes as "Proposed Model Law."

[55] Professor Schwarcz first made his proposal in 2000, although he originally used the term "Model Convention." Steven L. Schwarcz, "Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach," 85 *Cornell L. Rev.* 956 (1999).

[56] Proposed Model Law, art. 2.2.

Model Law would not require the adoption of a treaty or an international agreement but would become law as soon as one jurisdiction adopts it, thereby avoiding the pitfalls of previous attempts to manage debt restructuring through ambitious international treaties. Similar to other Model Laws, such as the UNCITRAL Model Law on International Commercial Arbitration, the Model Law would not operate as a treaty or a contract, but would instead provide a debt-restructuring framework that would be given the force of law by national and subnational jurisdictions.

The Model Law seeks to provide a voluntary, timely, and orderly approach to debt restructuring, and would allow a supermajority of bondholders to vote on, and bind all bondholders to, a restructuring plan.[57] It would address a debtor state's need for liquidity by granting a priority to new lenders over existing creditors, provided those creditors were given notice and opportunity to block the lending if the loan is too large or the terms of the loan are unacceptable.[58] The Model Law would also provide neutral supervision of debt restructuring processes, and would include an arbitration provision to avoid the pitfalls of disruptive litigation and promote expedient resolutions to disputes. The Model Law would only apply to future debt issuances, but could provide much-needed stability and oversight to sovereign debt restructuring while placing the onus of enactment and enforcement on national and subnational jurisdictions, thereby avoiding the pitfalls of ambitious treaty frameworks.

The laws and practice of the adopting jurisdiction would govern the Model Law (the **Model Law State**), which ideally will have characteristics that would make it well suited to govern the Model Law. Because most existing foreign-law governed sovereign debt is issued under either New York or English law, the Model Law's proponents believe that a successful Model Law State would most likely be a common law jurisdiction, in order to facilitate easier integration with existing capital markets and legal systems in London and New York. The ideal Model Law State would also have a strong reputation for financial stability as well as reasonably deep capital markets. It would also have a reputation for respecting the rule of law and civil rights, supported by a strong and respected independent judiciary. These traits would bolster creditor confidence in both the success of the Model Law and their own fair and equal treatment, and would ensure effective ongoing management of Model Law-regulated restructurings.

Several jurisdictions may meet these criteria. As mentioned above, Professor Schwarcz's proposal has been taken up by CIGI, and discussions have been commenced in two jurisdictions to explore the possibility of adoption.

Singapore is one possible Model Law State, building on its reputation for stability, rule of law, and strong capital markets. In October 2017, CIGI and the National University of Singapore's Centre for Banking and Finance Law hosted a roundtable to discuss Singapore's potential role as a Model Law State.[59] The well-attended conference included representatives from the Law and Finance Ministries, and the Singapore Monetary Authority. Singapore's neutrality and strong reputation for rule of law would support creditor confidence and reasonable expectations. Singapore's strong international law practice, particularly the Singapore International Commercial Court and the Singapore Arbitration Centre, are well equipped to resolve any disputes arising under the Model law. Through these fora and domestic laws, Singapore could establish itself as a global leader in sovereign debt relations, providing a benefit to both Singapore's legal and economic industries and contributing to a more stable global economy.

Ontario, Canada, is another possible candidate, with many of the advantages of Singapore (including a strong commitment to rule of law, a reputation for financial stability, and Toronto's position as an international financial centre).[60] A February 2017 conference in Toronto hosted by CIGI addressed Ontario's possible future as a Model Law State.

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[57] Proposed Model Law, art. 7(2).

[58] Proposed Model Law, arts. 8-9, Chapter IV.

[59] https://law.nus.edu.sg/pdfs/cbfl/events/SovereignDebtRestructuringRoundtable2017_post.pdf.

[60] Mark Jewett and Maziar Peihani, "How Ontario Could Lead the World in Sovereign Debt Restructuring," *Centre for International Governance Innovation*, Policy Brief No. 108 (May 2017).

A Model Law would not only benefit debtor states issuing capital, but could also be an economic boon to the Model Law State. It would increase the demand for both legal and economic expertise as creditors and debtors would require advice on issuing or accepting debt instruments.

Conclusion

- Recent developments demonstrate that sovereign debt crises will remain with us for the foreseeable future.
- Emerging situations in Ukraine and Venezuela add further urgency to the need for a comprehensive system of debt management.
- There are currently no viable prospects for an international treaty regime for managing sovereign debt restructuring.
- CACs remain an imperfect attempt to resolve debt issues; the "second wave" of CACs are a promising step in the right direction, but still fall short of a reliable and effective approach to addressing sovereign debt issues.
- Recent revisions to the IMF's LIA policy provide more flexible recovery options for debtors, and suggest less favourable treatment for entities that resemble or function similarly to holdout creditors.
- A Model Law approach has the potential to provide solutions to future sovereign debt crises.
- The ILA Sovereign Bankruptcy Study Group continues to work and report on the topic of sovereign debt restructuring

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VIII. Moving to a 'Direct Delivery' Model for the UK's High-Value Payment System

A. Introduction

Financial market infrastructures (FMIs) are fundamental to the smooth functioning of the financial system and economy. They make financial transactions more efficient by reducing the risks and costs involved in making payments and settling trades in financial instruments. FMIs must therefore operate reliably and in a stable manner.

Payment systems are perhaps the best known category of FMIs among the general public. In the UK, the largest and most systemically important payments are made over CHAPS, the United Kingdom's high-value payment system (HVPS).

Until recently, the delivery model for the CHAPS system involved a split in responsibilities:

- The core infrastructure was provided by the Bank of England (the Bank), as part of its Real-Time Gross Settlement (RTGS) system. RTGS is an accounting system that allows eligible institutions to hold reserves balances in central bank money at the Bank and settle obligations to each other.[61]

[61] RTGS settles over GBP 600bn of payments in real time each day, while eliminating settlement risk and with an extremely high degree of resilience, all at a cost – to direct participants – of less than one ten millionth of the value of the average payment. *See* Carney, M., (2018), "*The Future of Money*", a speech given at Edinburgh University: https://www.bankofengland.co.uk/-/media/boe/files/speech/2018/the-future-of-money-speech-by-mark-carney.pdf?la=en&hash=A51E1C8E90BDD3D071A8D6B4F8C1566E7AC91418.

- CHAPS Co, a private company owned by its member settlement banks, was responsible for operating the system's governance and rulebook and managing risks across the CHAPS system as a whole.

In November 2017, the functions performed by CHAPS Co were transferred into the Bank, making the Bank both the RTGS infrastructure provider and the CHAPS system operator. This 'direct delivery' model brought the UK into line with the overwhelming majority of other jurisdictions globally.

The Bank decided to make this change following a public consultation launched in September 2016,[62] with the Bank concluding that the ability to manage risks to the system end-to-end would enhance UK financial stability. This conclusion was endorsed by the Bank's Financial Policy Committee (FPC) and responded to recommendations made by the International Monetary Fund (IMF).[63]

The objective of this section is to highlight the main factors that led to the Bank's decision to move to a 'direct delivery' model, the road map of the transition and the key challenges the Bank has faced to date in the implementation of this transfer.

B. Background and history

The CHAPS system is the UK's sterling same-day system used for high-value wholesale payments – such as sterling money market payments, central counterparty margin and sterling legs of wholesale foreign exchange transactions – as well as time-critical retail payments such as house purchase transactions.

As noted above, the RTGS infrastructure and the CHAPS system supported previously had distinct institutional and governance arrangements. This previous structure arose through historical evolution; a privately-owned CHAPS Co pre-dated the Bank's involvement through RTGS.[64] This historic split was unusual among jurisdictions globally; a World Bank survey in 2012 found that 89% of 107 countries surveyed had central bank-operated HVPSs. In each of its last two Financial Sector Assessment Program reviews (2011 and 2016),[65] the IMF highlighted the unusual delivery model for the UK HVPS and, in 2016, the IMF recommended that the Bank should consider options for reform of this model to facilitate enhanced risk management.\

C. The financial stability case for direct delivery

In determining the financial stability case for moving to a 'direct delivery' model, the Bank took into account the material changes taking place in the payments landscape together with certain emerging risks and shifting regulatory expectations.

- ***The nature and scale of threats faced by FMIs generally have changed and intensified in recent years***. For example, the increase in the number and sophistication of fraud attempts and cyber-attacks in recent years – such as the "Bangladesh incident"[66] – appears to place financial institutions and FMIs at ever

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[62] *"A new RTGS service for the United Kingdom: safeguarding stability, enabling innovation" (*16 September 2016) online: https://www.bankofengland.co.uk/-/media/boe/files/payments/a-new-rtgs-service-for-the-uk-safeguarding-stability-enabling-innovation.pdf?la=en&hash=2FE6ABB33839969FDB3E07C538293DFE31CB4005.

[63] *See* the IMF's report at: https://www.imf.org/external/pubs/ft/scr/2016/cr16156.pdf.

[64] The Bank's RTGS infrastructure was introduced in 1996. Before RTGS, high-value interbank payments were settled on a deferred net settlement basis.

[65] *Ibid.* footnote 63.

[66] This involved cyber-attacks on various SWIFT users, including Bangladesh's central bank, and demonstrated how it is insufficient for an FMI to focus only on its core infrastructure or the system's end-points (i.e. the system's participants) in isolation.

greater risks of data loss and unauthorised payments through their membership of payment systems. To reduce the risk of such incidents, it has become increasingly important to assess and mitigate end-to-end risk – not just across the core infrastructure of a payment system but also across the entire "ecosystem", including a system's participants.

- ***The risk posed by these threats may be compounded by changes in the payments industry landscape – particularly the ongoing growth in the number of direct participants in the CHAPS system.*** As the number of participants grows, the risk of a threat penetrating part of the CHAPS system increases.

  Growth in direct participation in the CHAPS system over recent years can be attributed, among other things, to the actions which the Bank and CHAPS Co have taken to reduce tiering (i.e., requiring banks who are not CHAPS members but who make payments of a high value through a CHAPS member to join CHAPS directly in order to reduce settlement and liquidity risk). Looking forward, the number of direct participants may continue to grow as a consequence of:

  - the introduction of structural reform within major UK banking groups. This has led certain banking groups subject to ring-fencing requirements to seek an extra CHAPS membership so that both their ring-fenced and non-ring-fenced banks will be separate CHAPS participants; and

  - increased participation of new entrant banks and non-bank payment service providers in the CHAPS system (and other national HVPSs), some of whom may seek direct membership in order to compete with long-standing incumbent members on equal terms. UK[67] and EU[68] regulatory authorities have actively supported this change, provided that the HVPSs retain comprehensive risk management frameworks to ensure that their resilience is not compromised.

- ***This heightened risk environment in turn has driven commensurate increases in supervisory requirements on FMIs.*** The UK introduced a statutory oversight regime for systemically-important payment systems, operated by the Bank's FMI Directorate, in 2010. Internationally, CPMI-IOSCO published new Principles for Financial Market Infrastructures,[69] or PFMIs, in 2012. More recently, the Bank introduced further enhancements to its FMI supervisory approach, both in response to the PFMIs and of its own initiative.[70]

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[67] The Bank announced in June 2016 that it intended to extend direct RTGS access to qualifying payment and e-money institution payment service providers ("non-bank PSPs") authorised in the UK by the Financial Conduct Authority. *See* Carney, M., (2016), "*Enabling the Fintech Transformation*": https://www.bankofengland.co.uk/speech/2016/enabling-the-fintech-transformation-revolution-restoration-or-reformation.

[68] Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32015L2366.

[69] Principles for Financial Market Infrastructures (PFMI): http://www.bis.org/cpmi/publ/d130.pdf.

[70] http://www.bankofengland.co.uk/financialstability/Documents/fmi/fmisupervision.pdf, and https://www.bankofengland.co.uk/-/media/boe/files/annual-report/2016/supervision-of-financial-market-infrastructures-2016.pdf?la=en&hash=B6494E0BF2714C131B684ABA2DCED7B4F1793968.

As part of the September 2016 RTGS consultation, the Bank asked a wide range of stakeholders for their views on moving to direct delivery of HVPS.[71] At that point, the Bank acknowledged that CHAPS Co had taken important and effective steps to respond to new regulatory expectations: streamlining its governance arrangements, strengthening its rulebook, developing an improved member assurance model and deepening relationships with the Bank's RTGS operational team. However, given the structural constraints imposed by the then existing arrangements and the evolving risk environment, the Bank and its FPC concluded in May 2017 that financial stability would be enhanced if the United Kingdom adopted the 'direct delivery' model used in the overwhelming majority of jurisdictions globally.

D. The Transition

The Bank announced its decision to move to a 'direct delivery' model in May 2017 in its blueprint for a new RTGS service.[72] The Bank took due account of a full range of risk factors involved with the transition, including potential legal risks if CHAPS Co, its shareholders or its participants ultimately did not agree with the transfer of CHAPS Co's functions to the Bank.

Given the systemic importance of the CHAPS payment system to the UK financial system, the transition needed to be orderly and CHAPS direct participants needed to work collaboratively with the Bank. Following the Bank's announcement, a period of due diligence took place to allow the Bank to complete a full assessment of CHAPS Co's assets and liabilities. The Bank acquired CHAPS Co through a share purchase transaction that was completed in November 2017, with the Bank and CHAPS Co also putting in place related arrangements to move CHAPS Co's data and staff to the Bank. Through effective implementation and good levels of collaboration, the Bank and CHAPS Co successfully delivered a seamless transition which ensured that the payment system and its operations remained robust and resilient throughout, and that there were no issues around data security during implementation.

The combined RTGS and CHAPS service is now overseen by a new Bank RTGS/CHAPS Board composed of Bank executives and independent directors, and chaired by the Bank's Deputy Governor for Markets and Banking. The RTGS/CHAPS Board will first consider the Bank's monetary and financial stability objectives through promoting the safety, efficiency and effectiveness of the CHAPS system and acting as a systemic risk manager. Additionally, and where consistent with the Bank's statutory objectives, the RTGS/CHAPS Board will seek to enable fair and open access to the CHAPS system, based on reasonable risk-related participation requirements, as a means of promoting competition, innovation, and the interests of users.

The Bank is also in the process of establishing a new Strategic Advisory Forum, as well as continuing with the former CHAPS Co Service User Group,[73] to ensure that the Bank can continue to hear views from both senior industry stakeholders and a broader range of CHAPS payment system users.

As a further result of the change to a 'direct delivery' model, the CHAPS system was formally removed from the UK's statutory oversight regime for systemically-important UK payment systems.[74]

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[71] The Bank received 61 submissions in response to the 2016 RTGS consultation from stakeholders with varying perspectives on RTGS and the broader UK payments landscape, including banks and building societies, FMIs and payments schemes, technology providers, non-bank PSPs, fintech firms and individual experts.

[72] https://www.bankofengland.co.uk/-/media/boe/files/payments/a-blueprint-for-a-new-rtgs-service-for-the-uk.pdf?la=en&hash=56424C6BC6D9E056F05476A96B482D4779377E45.

[73] The Service User Group is a group open to organisations with an interest in CHAPS, such as direct and indirect participants, end-users and relevant trade associations. The Service User Group presents an opportunity to hear first-hand about delivery of the CHAPS system including benefits, risk reduction, and innovation. It also encourages input from service users in order for the Bank to be able to determine future demand as well as areas where support for users can be further improved.

The Bank's FMI Directorate will, however, continue to supervise its operation on a non-statutory basis, conducted to the same rigorous standard as the Bank applies to payment system operators falling within the statutory regime. The Bank's supervision of CHAPS will, therefore, continue to include:

- an annual assessment against the Bank's supervisory risk framework;
- periodic reporting requirements, regular supervisory meetings and a programme of core assurance reviews; and
- assessing proposed material changes to the CHAPS business model and risk profile to ensure that it does not increase risks to UK financial stability.

In order to ensure the effective supervisory oversight and operational delivery of the CHAPS system via a 'direct delivery' model, the Bank has designed a governance and institutional structure in support that is focussed on achieving independence between the separate areas of the Bank responsible for the operation and supervision of the CHAPS system. Further, the Bank has put in place measures to ring-fence specialist resources for both functions, and will report annually to the independent Chair of the Bank's Court (its board of directors) on the supervision of CHAPS.

E. Conclusion: how a 'direct delivery' model contributes to the Bank's mission

The move to a 'direct delivery' model for CHAPS in November 2017 was one of the first steps in the Bank's ongoing programme for RTGS renewal. It will allow the new RTGS service to be designed from the start in a fully holistic way, with end-to-end risk management which can make use of the full set of tools and resources available to the Bank to identify, mitigate and respond to risks as they emerge across the HVPS ecosystem as a whole. The Bank's aim is that the renewed RTGS should deliver a materially stronger, more resilient, flexible and innovative sterling settlement system for the UK's highest-value payments and should leave the UK with a world-leading payments landscape in the years ahead. In this way, the move to a 'direct delivery' model contributes directly to the Bank's mission to promote the good of the people of the UK by maintaining monetary and financial stability.

IX. Central Bank Digital Currencies (CBDC) Tokenized[75] Schemes – An Overview

A few central bank cryptocurrency schemes have been floating.[76] In the US, proposals have been made for Fedcoin, being a central bank-issued centrally created cryptocurrency, to be available to the public at large.[77] Digital coins are to be centrally issued on a blockchain-style decentralized ledger, but nevertheless with the central bank being in full control of quantity, timing, and fixed value in denominations of the national fiat currency unit of account. Effectively, transactions will be validated

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[74] Under section 184 of the Banking Act 2009, a payment system wholly operated by the Bank cannot be recognised by the UK Treasury for statutory oversight purposes. Note however that the CHAPS system remains designated in the UK for settlement finality purposes.

[75] For the "key distinction between token and account-based money" *see, e.g.,* CPMI-Market Committee, Central Bank Digital Currencies, (Base: BIS, March 2018) at 4, available online: https://www.bis.org/cpmi/publ/d174.pdf (accessed March 21, 2018).

[76] *See*: Morten Bech and Rodney Garratt, "Central bank cryptocurrencies" (2017) BIS Quarterly Review, at 55, online: https://www.bis.org/publ/qtrpdf/r_qt1709f.pdf (accessed 12 March 2018). *See also*: Katrik Hegadekatti, "Towards Regional Monetary Unions through Blockchain Networks" (2017) MPRA paper No 82838, online: https://mpra.ub.uni-muenchen.de/82838/ (accessed 12 March 2018); and Heike Mai, "Why would we use crypto euros? Central bank-issued digital cash – a user perspective" (2018) EU Monitor Global financial markets, online: https://www.dbresearch.com/PROD/RPS_EN-PROD/PROD0000000000462095.PDF (accessed 12 March 2018).

[77] *See, e.g.,* Wendy McElroy, "Fedcoin: The U.S. Will Issue E-Currency That You Will Use", *Bitcoin.com* (12 January 2005), online: https://news.bitcoin.com/fedcoin-u-s-issue-e-currency/ (accessed 28 December 2017).

by an independent notary nominated by the central bank. A similar proposal was made in the UK for RSCoin.[78] Another proposal is for a NationCoin, being a Regulated and Sovereign Backed Cryptocurrency (RSBC). The scheme envisages cryptocoins, which as in Bitcoin, will be created by and transacted over a blockchain. Upon their creation, cryptocoins will be stored, and released to the public by a Digital Asset Reserve, as RSBC, at the fixed value of the national unit of account. Transactions are to be verified by 'miners' who will be paid freshly minted cryptocoins.[79]

As a proof of concept (PoC) both Bank of Canada under the Jasper Project[80] and Monetary Authority of Singapore under the Ubin Project[81] experiment with a DLT-based wholesale payment system premised on the use of a blockchain for interbank settlement in central bank money. Thereunder, the central bank issues to each participating bank digital depository receipts against the security of funds withdrawn from the reserve account of that bank. For each payment order processed, interbank settlement continuously takes place by transacting with these digital receipts over the blockchain. Both entered a collaboration to test and develop a cross-border solution using crypto tokens issued by the two central banks.[82]

In Jasper, Digital Depository Receipts (DDRs) issued by the Bank of Canada are secured by an omnibus account in which each participating bank deposits central bank money withdrawn from its settlement account. In Ubin, Depository Receipts (DRs) are issued by the Monetary Authority to each participating bank against central bank money deposited by the latter in an individual cash custody account held with the former. In Ubin participating banks may hold deposit receipt balances on the blockchain overnight and have greater flexibility in pledging and redeeming DRs during operating hours. In Jasper DDRs are created and destroyed upon redemption on a daily basis.

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[78] *See* George Danezis and Sarah Meiklejohn, *Centrally Banked Cryptocurrencies* (London: University College London, 2015), online: https://eprint.iacr.org/2015/502.pdf (accessed 28 December 2017). In part this article is too technical to the uninitiated in computer science and related subjects (including myself). "RSCoin is the core of a system of scalable and auditable transactions, not a full product" which thus could be used as a basis for either a retail or wholesale product. Email message to the author from George Danezis dated 4 December 2017.

[79] Kartik Hegadekatti and Yatish S G, "Generation, Security and Distribution of MationCoins by a Sovereign Authority" (7 Jan 2017), online: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2888347 (accessed 28 December 2017).

[80] *See*: James Chapman, Rodney Garratt et al., "Project Jasper: Are Distributed Wholesale Payment Systems Feasible Yet?" (2017) Bank of Canada Financial System Review, online: http://www.bankofcanada.ca/wp-content/uploads/2017/05/fsr-june-2017-chapman.pdf (accessed 28 December 2017). For the earlier stage of the project see Rod Garratt, "CAD-coin versus Fedcoin" (May 2017), online: https://www.finextra.com/finextra-downloads/newsdocs/cad-coin-versus.pdf (accessed 28 December 2017). *See also*: Laura Shin, "Canada Has Been Experimenting With A Digital Fiat Currency Called CAD-COIN", *Forbes* (16 June 2016), online: http://www.forbes.com/sites/laurashin/2016/06/16/canada-has-been-experimenting-with-a-digital-fiat-currency-called-cad-coin/#536fabe91b0c (accessed 28 December 2017); Pete Rizzo, "Bank of Canada Demos Blockchain-Based Digital Dollar", *CoinDesk.com* (16 June 2016), online: http://www.coindesk.com/bank-canada-demos-blockchain-based-digital-dollar/ (accessed 28 December 2017); and Claire Brownell, "No cryptocurrency anytime soon, Bank of Canada says: 'We're very far off'", *Financial Post* (17 June 2016), online http://business.financialpost.com/news/fp-street/no-cryptocurrency-anytime-soon-bank-of-canada-says-were-very-far-off (accessed 28 December 2017).

[81] *See*: Deloitte & MAS (Monetary Authority of Singapore), "The future is here – Project Ubin: SGD on Distributed Ledger" (2017), online: http://www.mas.gov.sg/~/media/ProjectUbin/Project%20Ubin%20%20SGD%20on%20Distributed%20Ledger.pdf (accessed 28 December 2017).

[82] Speech by Ravi Menon, Managing Director, MAS, at Money20/20, today, 15 March 2018: http://www.mas.gov.sg/News-and-Publications/Speeches-and-Monetary-Policy-Statements/Speeches/2018/Crypto-Tokens-The-Good-The-Bad-and-The-Ugly.aspx?from=timeline&isappinstalled=0 (accessed March 19 2018).

Ubin uses a system built on the Ethereum platform. This was true for the first phase of Jasper (Jasper 1). This platform uses Proof of Work (PoW) consensus protocol, requiring expensive computations to validate transactions and update the ledger. For that reason the second phase of Jasper (Jasper II) switched to the Corda platform in which a notary function replaces that of the PoW:[83] The notary role in Jasper II is assigned to the Bank of Canada. As such it has access to the entire ledger and is able to verify that the funds involved in a transaction are available.

Jasper II improved on both Jasper 1 and Ubin in facilitating a liquidity-saving mechanism (LSM) in the form of a payment queue with periodic multilateral payment netting for payments designated as 'non-urgent'.

In the final analysis both Jasper and Ubin have been successful as a proof of concept for a DLT-based interbank settlement system that has the potential of replacing the traditional Real-time Gross Settlement (RTGS). However, in assessing Jasper, it was concluded that:[84]

- For critical financial market infrastructures, such as wholesale payment systems, current versions of DLT may not provide an overall net benefit relative to current centralized systems. Recent versions of DLT have, however, made advances compared with initial cryptocurrency applications of DLT.

- Benefits for the financial system of a DLT-based wholesale payment system could likely arise from its interaction with a larger DLT ecosystem of financial market infrastructures, potentially including cross-border transactions

Finally, this section addresses centralized schemes making digital currency available to the public at large. The United States Federal Reserve established in 2015 a 331-member Faster Payments Task Force to support a broader effort to improve the speed, safety, and efficiency of payments.[85] On March 29, 2016, McKinsey & Company was selected to support Faster Payments Task Force efforts to assess faster payments solution proposals from various providers across the United States payments industry.[86] Among the 17 faster payments solutions, WingCash came tied in the first place.[87] Its proposal is described as:

> A software platform that would be owned and operated by the Federal Reserve and the Governing Organization.[88] The Federal Reserve would issue digital currency (digital Fed notes) and is tied to the Internet domain (Fednotes.com).

This faster payment solution proposal "seek[s] to make it possible for any entity to transfer value electronically using methods that seek to preserve and to emulate physical currency." Accordingly, its Faster Payments Network (FPN) will allow "persons and businesses to hold and transfer digital Fed

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[83] James Chapman, Rodney Garratt et al., *supra* note 80 at 5.

[84] James Chapman, Rodney Garratt et al., *supra* note 80 at 1.

[85] "Strategies for Improving U.S. Payment System" (26 January 2015) Federal Reserve System, online: https://fedpaymentsimprovement.org/wp-content/uploads/strategies-improving-us-payment-system.pdf (accessed 28 December 2017).

[86] "Federal Reserve engages in effort to access faster payments solutions" (29 March 2016) Federal Reserve, online: https://www.federalreserve.gov/newsevents/press/other/20160329a.html (accessed 28 December 2017).

[87] See "The U.S. Path to Faster Payments FINAL REPORT PART TWO: A CALL FOR ACTION" (July 2017) Faster Payments Task Force at 13, online: https://fasterpaymentstaskforce.org/wp-content/uploads/faster-payments-task-force-final-report-part-two.pdf (accessed 28 December 2017).

[88] Defined in the Glossary as "The executive officers, board of directors and board of advisors responsible for governing the Raster Payments Network [- FPN]".

notes for payment, with the direction of payment flow from the Payer directly to the Payee." Thus,[89]

> … the FPN specifies a single Internet domain … where the Federal Reserve publishes digital bills and coins (Fed notes). Each Fed note is a unique web page with an immutably assigned URL that includes both a currency code (e.g., USD) and a unique identifier similar to a serial number… Combined these components form a unique immutable address for each Fed note …

The Fed notes would constitute 'legal tender' so as to be the equivalent of US physical currency. "[E]ach Fed note is assigned a single, permanent, monetary unit of value "… as well as 'a field that stores the URL of the issuer … and a field that stores the URL of the current holder….'" Each Fed note would be cryptographically 'signed' by the 'Fed' using 'asymmetric (public key) cryptography' (PKC), with the Fed also acting as the Certificate Authority (CA). Fed notes are to be transferred by means of an exchange of cryptographically 'signed' messages from the payer to the Fed, (with a copy to the payee) followed by a message from the Fed to the payee. With the completion of each payment, the FPN updates the possession of attribute of the Fed note from the payer to the payee. In the process, the Fed thus acts not only as the issuer but also as a controller of the Internet domain associated with each Fed note and custodian of the transfer record.

The WingCash proposed solution envisages the use by the Fed of the WingCash platform. It is a platform that allows a safe and secure transfer of value among individuals and businesses. The Network has two distinct parts: one allowing Treasury to design and issue digital Fed notes. The second is to be operated by the Fed (either directly or through a Governing Organization), and consists of a global directory service distributing the digital notes and recording their transfer. Initial distribution is to be made by the Fed to banks, which will make the digital notes available for withdrawals to their customers. Both successful competition and interoperability with existing networks such as ACH and cards is anticipated.[90]

Another technology to be addressed is that of *BitMint*, facilitating, among other features, a centralized scheme for a non-speculative and stable currency, consisting of randomized coins, each expressing a claim-check to a defined quantity of a specific commodity, including a fiat currency.[91] BitMint keeps 100% reserve so that the purchasing commodity or fiat currency is always available for redemption on demand and may be tethered.[92] BitMint is said to be identified as "the only candidate qualifying as a universal digital representation of worldwide currencies"[93] and is suitable as a digitized central bank

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[89] WingCash (Proposer), "Faster Payments QIAT" (21 February 2017) at 11 and 14, online: https://drive.google.com/file/d/0B_CNPQWTRQwuZWhqbDUzNVJsNGc/view (accessed 28 December 2017).

[90] For extensive information, *see* documents accessed (through 'WingCash') *ibid.* at 13: http://fasterpaymentsnetwork.com/ (accessed 28 December 2017); https://drive.google.com/file/d/0B_CNPQWTRQwuc1hhWlAzOEljNGs/view (accessed 28 December 2017); and https://drive.google.com/file/d/0B_CNPQWTRQwuZWhqbDUzNVJsNGc/view (accessed 28 December 2017).

[91] For detailed information on BitMint (not to be confused with BintMinter), *see, e.g.*: http://www.bitmint.com/ (accessed 12 March 2017); http://finder.startupnationcentral.org/company_page/bitmint/ (accessed 12 March 2017), and sites and videos accessible through it; and https://medium.com/@bitmintnews (accessed 12 March 2017), and associated articles.

[92] Gideon Samid, Tethered Money: Managing Digital Currency Transactions (London: Academic Press, 2015) at 108.

[93] *See* this quote from Helmut Scherzer, Senior Principal Technology Manager for Giesecke & Devrient at the Chip-to-Cloud Security Forum, held September 25-17, 2013, Nice, French Riviera. It is online at slide no. 16 in http://pennwell.sds06.websds.net/2015/amsterdam/slideshows/T1S7O3-slides.pdf (accessed 28 December 2017).

currency.[94]

X. Update on the Current Regulatory State of Fintech in the EU

Financial Technology (FinTech) is part of the EU Commission's priority of establishing a Capital Market Union (CMU). The CMU Action Plan[95] includes the following issues:

- broadening access to finance for SMEs, in particular for innovative companies, start-ups and scale-ups;
- assessment of how FinTech can contribute to deepening and broadening EU capital markets;[96] and
- improving financial services for consumers.[97]

In this context, the EU regulators have been dealing with crowdfunding and crowd investment since 2013. So far, shaping out related frameworks has been left to the national regulators,[98] including, e.g., Austria,[99] France,[100] Germany,[101] and the UK.[102] However, it seems time has come to tackle a certain degree of harmonisation. In October 2017, the EU Commission launched a so-called Inception Impact Assessment is respect of a "legislative proposal for an EU framework on crowd and peer to peer finance"[103] in order to address two main problems:

- Market fragmentation and lack of scale. "Continued low levels of cross-border flows may be partly attributed to differences in national regulation, which increases transaction costs."[104]
- Lack of liability of crowdfunding and peer-to-peer platforms. "The biggest risks perceived are loan defaults or business failures, fraudulent activities or the collapse of platforms due to malpractice. This reflects concerns about weak governance practices, notably in areas such as risk management or the prevention of conflict or misalignment of interests."[105]

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[94] For details, see Gideon Samid, "Bitcoin.BitMint: Reconciling Bitcoin with Central Banks", BitMint, LLC, online: https://eprint.iacr.org/2014/244.pdf (accessed 28 December 2017). *See also e.g.* http://www.bitmint.com/bitcoin.htm (accessed 28 December 2017).

[95] COM (2015) 468 final, 30.09.2015.

[96] 2017mid-term review of the CMU Action Plan, COM (2017) 292 final, 08.06.2017.

[97] Action Plan on Consumer Financial Services, COM (2017) 139 final, 23.03.2017.

[98] For a global overview *see* Follak, Crowdfunding in International and National Regulatory Frameworks, B.F.L.R. Vol. 32.1(2016), pp. 167, and Crowdfunding , ÖBA 2016, pp. 890.

[99] AltFG, Austrian Federal Law Gazette (BGBl) I No. 114/2015.

[100] Order of 30th May, 2014.

[101] Capital Investment Act, German Federal Law Gazette (BGBl) I, 2015, pp.1245.

[102] The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realisable securities by other media, PS 14/4, March 2014.

[103] Ref. Ares(2017)5288649-30/10/2017.

[104] Ibid., p.2.

[105] Ibid., p.2.

The aim is to enable platforms to scale cross-border, and to provide for a proportionate and effective risk management framework. For this purpose, the following policy options will be assessed:

- Option 1: Baseline scenario – no EU framework;
- Option 2: A self-regulatory approach with minimum EU standards;
- Option 3: Comprehensive EU regulation;
- Option 4: Standalone opt-in EU framework for platforms conducting cross-border activities.

If a legislative approach is taken, the next step would be an implementation plan.

A further area of action is the implementation of the Basel Committee's paper "Sound practices: Implications of fintech developments for banks and bank supervisors",[106] finalised in February 2018. It comprises 10 key implications and considerations:

1. the overarching need to ensure safety and soundness and high compliance standards without inhibiting beneficial innovation in the banking sector;
2. the key risks for banks related to fintech developments, including strategic/profitability risks, operational, cyber- and compliance risks;
3. the implications for banks of the use of innovative enabling technologies;
4. the implications for banks of the growing use of third parties, via outsourcing and/or partnerships;
5. cross-sectoral cooperation between bank supervisors and other relevant authorities;
6. international cooperation between bank supervisors;
7. adaptation of the supervisory skill set;
8. potential opportunities for supervisors to use innovative technologies ("suptech");
9. relevance of existing regulatory frameworks for new innovative business models;
10. key features of regulatory initiatives set up to facilitate fintech innovation.

Related approaches are being integrated into the Single Supervisory Mechanism of the Euro area. In this context, the ECB has issued a "Guide to assessments of fintech credit institution licence applications".[107] In line with the ECB's responsibilities, this guide exclusively refers to bank business models in which the production and delivery of banking products and services are based on technology-enabled innovation… The ECB's role is to ensure that fintech banks are properly authorised and have in place risk control frameworks for anticipating, understanding and responding to the risks arising in their field of operations. Equally, to ensure a level playing field, fintech banks must be held to the same standards as other banks."[108]

[106] https://www.bis.org/bcbs/publ/d431.htm.

[107] ECB, September 2017.

[108] Ibid., foreword, p.2.