School of Law UNIVERSITY OF LEEDS

Conference Report

Inaugural Conference on Recent Developments in Insolvency Law Reflections on the Pandemic and Brexit

Centre for Business Law and Practice (CBLP)

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Friday, 13 May 2022, 14:30-19:30 (UK time)

[Online event]

On 13 May 2022, the University of Leeds School of Law's Centre for Business Law and Practice (CBLP), directed by Professor Peter Whelan, hosted its Inaugural Conference on Recent Developments in Insolvency Law. The conference focused on the recent tendencies and developments related to Brexit, in particular from a cross-border perspective, as well as on the effects of the COVID-19 pandemic on insolvency law and regulation from an interdisciplinary perspective. A keynote talk was followed by three panels on corporate, banking, and sovereign insolvency and debt respectively.

The views expressed by the Speakers in this Conference Report reflect those of the Speakers in a personal capacity, and do not necessarily reflect those of their institutions. The editors of this Conference Report, Dr Virág Blazsek, Dr Oriana Casasola, and Dr Karina Patricio Ferreira Lima are very grateful to Ceren Gunes for excellent research assistance, to Beth Hastings-Trew and Amar Sandhu for excellent technical assistance as well as to Professor Peter Whelan for his leadership in the course of this conference project, and the School of Law, University of Leeds community for the support.

The transcripts of the Q/A sessions following each Panel are not included in this Conference Report. A recording of the event is available Online.

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Opening by Professor Peter Whelan

For those who do not know me, my name is Professor Peter Whelan. I am the Director of the Centre for Business Law and Practice (CBLP), which is based in the School of Law at University of Leeds. On behalf of the Centre that is hosting today's Conference, I would like to welcome you all to today's conference. It is great to see so many people here. We have over 200 registered for the event so it is great to see such interest in support for the conference.

In a moment, I will pass you over to my colleague, Virag, who will introduce our Keynote Speaker, Professor Richard Squire from Fordham Law School. But, before doing that, I would like to do two things. The first thing is just to give a little bit of context about the Conference itself. The CBLP is one of the largest research centres in the UK that focuses on research in Business Law broadly understood. We focus on many different aspects of such law, including: Tax Law, Antitrust Law, Corporate Law, Banking Law, and Environmental Law, for example. We have a variety of different scholars here, focusing on different issues in Business Law. In fact, we have over 30 members of full-time staff. And, we have around 50 PhD students. Unsurprisingly, given the size of the Centre, we have amongst our members, some established senior academics in the field of Insolvency Law. But also, we have a new generation of impressive scholars in this particular area, and that is what the Conference today is really all about. About celebrating that. Of course, I should mention Virag, and Oriana, and Karina, who have organised today's Conference. The CBLP is dedicated to this area of research. We want to invest in it, and we want to support our colleagues who are researching in it. The Conference is evidently part of that support. The aim here is to launch an annual conference, which will hopefully be face-to-face in Leeds at some point in the future. Hopefully too the Conference will inspire some substantive collaboration in future. So, that is the institutional context to the Conference. I should say a big well done to Virag, Karina, and Oriana for organising this Conference so well.

The second thing I want to do is just simply to say thank you to all of our speakers. It means a lot to us; it is a real honour and privilege to have you here, helping us, supporting the Centre and our scholars in this particular field. So, thank you for that. I hope you all enjoy the Conference; it promises to be an excellent Conference. I will now pass you over to my colleague, Virag, who will introduce our Keynote Speaker, Professor Richard Squire.

Introduction of Keynote Speaker Dr Virág Blazsek

Thank you very much, Peter, for your kind words. Good morning, good afternoon, or good evening, depending on your location! It is great to have you here. Please keep your microphones off if you are not speaking so we can have a high-quality recording of today's event. A warm welcome everybody. Thank you very much for participating in our Conference today, it is particularly wonderful to welcome our speakers from three continents and over a dozen different jurisdictions. It is my honour, and my pleasure, to introduce our Keynote Speaker, Professor Richard Squire who teaches at Fordham Law School in New York City and writes about Bankruptcy Law and Corporate Law. Professor Squire will talk about 20-25 minutes, and he agreed to answer a few questions following his keynote, which I will moderate. Richard, over to you.

Keynote by Professor Richard Squire: Is an Insolvency Pandemic Headed toward US?

Thank you very much Virág, thank you for organising this event and for inviting me to play the role of giving the keynote talk. Thank you also to Professor Whelan, Peter, for your introduction, and for this event. I am very excited about this conference and about the work that the Centre for Business Law and Practice is doing at the University of Leeds School of Law. I like this optimistic note that this is the first of a series of conferences, and I hope that they are in person, indeed, in the future. I also want to say thanks very much to everybody who is attending across, I guess daylight on the Earth from the Western Hemisphere, where it is morning, to Europe where it is afternoon. We are really getting good Friday night energy from the folks joining us from Asia; you could hear it from Aurelio and their exchange. You can tell it is Friday night there, so thank you for joining us as well.

So, I am bringing up now - and I hope this is visible to everybody - my slides. The title of my talk is "***Is an insolvency pandemic headed toward US?***" I know the theme of the conference is recent developments in Insolvency Law, especially as it relates to the COVID pandemic and how that might have influenced this area of law, and really the financial factors associated with it. So, I will focus on that talking about recent developments and also projecting a bit into the future. I capitalised 'US' in my title there because, it is a bit of a caveat; I am going to be focusing on the United States. I am obviously an American and United States is my country of expertise. It is where I can speak, I think, most informatively about developments and also about the institutions that are relevant here. With that said, I think that many of the dynamics that I will be describing here are effectively universal, or at least they apply across developed countries; counties with developed economies. I think that there are broader lessons, and toward the end, I will make a few comments about the UK in particular, as well, where I believe we are seeing developments that are parallel to those that I will be focusing on here.

So, one thing which we will just start off with talking about some macroeconomic indicators in the United States; here are the GDP quarterly changes for the last 20-21 years, really the 21st century. You see three recessions here - those are the grey areas - the one that was of interest to everybody in Insolvency Law was of course the Great Recession around 2008 where we had, what was at the time, a severe drop in economic output that lasted for a long time and is associated with a banking and financial sector panic. But now, if we go over to COVID, early 2020, I am going to call this the 'COVID Plunge', we see something very interesting. A much more severe drop in economic outputs followed by an almost equally astonishing spike in economic output. We crashed and then immediately recovered in a very dramatic way.

So, what does this mean for insolvencies - what we call in the United States bankruptcies? Well, here is a chart of business bankruptcies; this is not all business failures in the United States, some companies liquidate outside of our bankruptcy procedure. But, nonetheless, this is a good indicator and, as we saw back in the so-called Great Recession, one of the biggest spikes in business bankruptcies in American history. Going from about 20,000 companies to more than 60,000 in the course of just a couple of years. If filing for business bankruptcy per year declined during good times, you might expect to see a similar spike during that severe COVID downturn. But what we see instead is the opposite. Not an increase in business bankruptcies, which we should expect in a recession, but actually a fall. So, the question would be: how did that happen, and also, is it sustainable? If we look at bank failures, we are also going to have a panel today on banking insolvency, so let us look at that as well. Of course, the Great Recession - the financial crisis - was associated with a big jump in bank failures in the United States and, I know internationally as well. There are two lines here, one is total assets, that is green, the other is individual units of bank failures, as the red line. But these are unprecedented times since the American Great Depression. But during COVID, there were only four bank failures in 2020, and none in the United States in 2021. So, somehow the opposite happened - why is this happening?

Why has COVID not caused business bank insolvencies in the US? Hypothesis number one: firms and banks deleveraged ahead of COVID. So, you could check this to see they all say ‘we do not want any debt anymore after the Great Recession, it is just too dangerous let us put all equity financing this fall’- so I could show you some graphs on this. But you can trust me, for now, that if you look at debt, they actually, for both companies and banks, they increased in the last decade and now they are at an all-time high; so it is not deleveraging that is keeping these companies out of bankruptcy. So, second hypothesis: firms and banks received unprecedented direct and indirect cash infusions from the Government and that is why they have stayed afloat. - That is demonstrably true. In the last couple of years, the US Federal Government have spent $5T - that is trillion dollars - on COVID relief spending. There is a bit of a break down here. I will not go through all of the items, but the two biggest line items are spending that went around to individuals and families - which was $1.8 trillion - and then direct aid to businesses - another $1.7 trillion. Obviously, $1.7 trillion directly to businesses is going to help them weather the storm of the ‘COVID plunge’. But also, this aid went to families as well because many Americans were temporarily unemployed - some still are - or they left the workforce during the COVID plunge because lockdowns and other concerns. Because they were receiving cash from the Government, they kept spending, and so, firms could keep selling, and so they were able to stay afloat. This is the most likely explanation for why we did not see lots of failures in businesses and banks associated with the COVID plunge.

I said this is unprecedented; so you want to see the impact of the spending relative to the US Gross Domestic Product (GDP). Here is the federal spending as a percentage of GDP. Before the Great Recession, it was under 20%, jumped up during the Great Recession to about 24%, declined back toward 20, and then we see this astonishing increase from 2019-2020. Outside of wartime, World War II, this is the biggest one-year jump in federal spending. So, it really is unprecedented - about twice the increase in spending we saw during the Great Recession.

How was this paid for? Two broad buckets are possible when the Government spends lots more money. It can raise taxes, or it can borrow it - it borrowed essentially all of it. Taxes actually were cut a bit on businesses as well, so it borrowed it all. Here is the federal deficit as a percentage of GDP. It drops to peacetime levels that were unprecedented during the Great Recession, came back up, now we have records outside of the Second World War. 15% of GDP, that is just the deficit in federal spending. And so, naturally, if the Government is going to be borrowing lots more money, trillions of dollars more, to fund all of this COVID relief spending, US Treasury debt outstanding is going to jump. Now, this is perhaps the most extraordinary of all of the graphs I am going to be showing you. Before the Great Recession, federal debt held by the public - there is a problem with that term, but that is the way it is described officially, and I will explain the problem in a couple slides - typically was in the United States’ less than 40% of GDP, again outside wartime. Jumped up during the Great Recession, continued to rise, but then during the COVID spike had a plunge; had an unprecedented jump as well to more than 100% of GDP. So, the Federal Government owes face value of debt more than the annual Gross Domestic Product in the United States.

Okay, so, this nationally means there is a huge increase caused by the Federal Government in demand for credit, or demand for loanable funds. Now it is kind of basic supply and demand analysis - you have a loanable funds market, you have supply of it and demand for it - the

Federal Government, by borrowing trillions more, increases demand. What will you expect when there is an increase in demand in the market? Well, you are going to expect higher prices, and higher prices for loanable funds mean higher interest rates, so that is what we should see. First of all, we see higher interest rates on federal debt, but that should flow through because federal debt sets the risk-free rate, that should flow through the higher borrowing costs for all borrowers in the economy. Now, this is ceteris paribus analysis, meaning that I am assuming that only the demand for loanable funds for credit has increased, there is not this change in the supply. Increase in demand, no change in supply - there should be a big jump in the price, i.e., the interest rate.

Is that what happens? So, here is the yield on 10-year Treasury debt, which is the effective interest rate. And, what happened during the COVID plunge? It plunged as well, so interest rates went the other way than what I said economic theory should indicate. Demand went up and yet the price went down; interest rates went down. This is a pretty good deal for the United States Government; it is borrowing, more than ever, and it is paying a lower interest rate than ever. So, how in the world could that be happening?

So, what happened is, there was a huge increase in the Unites States in the Federal Reserve which went into the market and started buying debt. The Federal Reserve went into unprecedented levels; as the United States Treasury was borrowing more money, federal debt held by the public is increasing. Simultaneously, the Federal Reserve, which is the American Central Bank, was buying lots more debt as well. So, the bullet points here are correct - all was not the same; the supply of loanable funds also rose. The Federal Reserve purchased, which is effectively monetising more than 100% of the debt issued by the Treasury. As this debt is being issued, our central bank is buying the debt and converting the cash. This means that debt held by the public really is not increasing. When the Federal Reserve and the Central Bank holds Treasury debt that means that effectively the US Treasury does not have to pay interest on it. It is basically like an interest free loan. So, instead of having a big increase, effectively, in debt, we have a big increase, effectively, in cash. This, also, was helpful for companies. The yield on corporate bonds, even though there is now much more competition in the borrowing market from the Treasury, the yield on corporate bonds also fell during the COVID plunge - I will talk about that later - at the same time that Treasury debt yields were falling as well. And so this is really a double benefit that was provided by the United States Government to businesses and banks during the COVID plunge. First of all, there was lots more aid from spending on Congress and then also the Fed monetised that rate.

Okay, so we have now this big influx, lots more cash coming into the economy. Where can that cash, where is that cash going to go as the Federal Reserve is printing lots more money to monetise the debt? Well, there is really two places it can go. One place that it can go is into bank reserves, and certainly it did - this is also an extraordinary graph. If you look before 2008, bank reserves - and these are commercial banks in the United States - was very low. This is non-circulating cash basically parked in an account at the Federal Reserve, because the Central Bank also acts as a bank to other banks. Before 2008, commercial banks wanted to keep as little money as they could in reserves, because it did not pay any interest; they want to lend out as much as possible, because it was productive. During the Great Recession, the Federal Reserve started paying interest on reserves, now it was productive money. Suddenly reserves started increasing in the United States Bank Reserves, and then during the COVID recession spiked by basically about $2 trillion dollars. A lot of that money printing did go into bank reserves; but it did not all go into bank reserves. A lot of it also came out into the economy and start circulating, so this is just dollars in circulation, that is not a part in bank reserves, but are actually out there, buying goods, services, assets, and so on. Circulating US dollars have doubled since 2012 and they have increased 26% just the start of 2020.

So, this is an inflation of the money supply; the Federal Reserve in the United States has inflated the money supply massively in response to the COVID crisis. Basic economics, again, what does inflation of the money supply entail for insolvency, really, for the entities that we are concerned about? Well, it is going to benefit borrowers by cheapening the repayment medium. If dollars are getting cheaper, then it is easier for you to repay debts, and so this helps explain a lack of borrower insolvency in recent years. It also helps the Government and enables high government spending through lower government borrowing costs. Inversely cheapening the money supply; inflating the money supply harms creditors and, by the way, that includes anyone who holds currency. If you hold dollars or any other currency, you are a creditor because you are holding a credit against the economy, against goods and services that other people sell and you might be able to retain later. So, creditors were hurt by low bond yields and dollar holders are going to be hurt if you inflate the money supply by asset inflation and by consumer price inflation. Did we have those? Yes, we did. Here is the stock market in the United States; the S&P 500 - massive asset price inflation, massive stock inflation. It is going up over time, drops quickly during COVID, but now is going up to an all-time bit of a fall recently, but reach all time high levels in just two years. Can this be explained by fundamentals in the US economy? It certainly cannot; this is inflation, driven by money printing.

How about house prices? This is another type of asset price inflation. House prices went way up before the Great Recession. That crash in house prices is the reason for the Great Recession and the financial crisis of 2008, one of them. Now, we are back to even higher levels, and asset house prices have been galloping in the last two years, in the United States; cannot relate this to fundamentals, we do not have population growth or anything different. So, that is explained by all that money printing by the Fed's monetising all of that additional borrowing by the United States Treasury. And then, finally, not just asset price inflation, but also consumer price inflation. Here, I go back a little bit further - my graph goes all the way back to 1980. The reason I am going back to 1980 was record high inflation, consumer price inflation in the United States. The Federal Reserve back then very aggressively raised interest rates; it shrank the money supply to fight it. But now, we are going all the way back to the right side of our graph. We see the highest consumer price inflation in 40 years in the United States - two different measures; one is core inflation, the other is not, but it is basically telling the same story. Inflation, consumer price inflation - this is gasoline, this is food, baby formula is hard to find in the United States right now - you may have heard about that, clothing, groceries, rent, everything is, when it is this high, it is politically unacceptable. Fed has to do something; it is damaging to the credibility of the Fed and to the credibility of the Federal Government. The Fed has to try to intervene now, stop printing money and do something the opposite.

On May 5th of this year, 2022, the Federal Reserve announced a 50 basis point increase in the federal funds rate, which is overnight interbank rate. That is accomplished by paying more interest on bank reserves - the Fed is now paying interest on reserves, well now it is paying more. It announced that more increases are expected in coming months. If the Fed pays more interest on reserves, money that is circulating, there will be less of it - more of it will go into reserves, and so the effective money supply will contract more aggressively. The Fed also announced that it intends to shrink its balance sheet by selling off all those Treasury bonds that it was buying earlier when it was monetising all of that debt issued because of the federal spending in response to COVID. As the federal reserve, the Central Bank sells Treasury bonds. Money comes out of the economy, because it sells that money as the bonds for cash, which it then retires, effectively. The predictable consequence of the decreased supply of credit of loanable funds is that the Fed is no longer supplying loanable funds, it is actually subtracting loanable funds for higher prices, i.e., higher interest rates.

Now, I am looking at the yield on Treasury bonds - we saw this before, 10-Year Treasury bonds - but I am zooming in just the last 3 years. We see that interest rates are now rising. They are rising for two reasons; the big increase is just in the last few months, although they have been creeping up since the end of that COVID recession - that very, very deep COVID recession. Part of this is just national inflation; it is going to cause buyers to require a higher return, to get a higher yield return on Treasury bonds. This more recently is anticipation of higher interest rates, shrinking of the money supply by the Fed. Our bond yields are doing the same thing again. During the last 3 years, they plummeted as the Fed's started buying all those Treasury bonds, expanding the money supply and now yields are increasing in anticipation that the Fed is going to reverse course and shrink the money supply.

So, we talked a little bit earlier about some of the economic impacts of increasing the money supply, but now we are going the opposite direction; we are going to have the opposite consequences. Borrowers - which includes, of course, business firms - are going to be harmed because the repayment medium has become more expensive. For businesses, this means higher borrowing costs; some will likely fail, just because they cannot service debt anymore. Now, debt servicing will become particularly difficult for actual price deflation to occur, but I do not think it is going to go that far. The Government is a net borrower who will also have to pay more interest on its debt, so that is going to be harmful as well. Creditors, conversely, are benefited, as seen in rising bond yields. However, if the contraction of the money supply causes a recession, that could harm creditors due to the falls. Will this cause a recession? I do not see any way to avoid that given the amount of money tightening that has to occur. Let us zoom in now on the US Government in particular.

I am talking about the United States Treasury, the Federal Government, not the Fed - the Central Bank. It is the one that is contracting or depleting the money supply. How is this going to affect the United States Government? Currently, the Federal Government - or the Treasury - pays about 1.5% interest rate on its debt; that is a weighted average of all of the different interest rates it pays on its various securities. That works out to about $250 billion annually, which is about 1.1% of America's Gross Domestic Product. Now, as the interest rate is rising, because we are contracting the money supply, that is going to add about $170 billion per year in additional debt servicing costs on the Government. If the interest rate rises all the way to 9% from 1.5%, the interest charge increases; will be over about $1.3 trillion, which is over 5% of American's GDP. That is additional spending that the Government will have to do - another $1.3 trillion - just to service current debt levels. Why do I say 9%? Why do I think the interest rate provides that high? There is a bit of a rule-of-thumb among central bankers, I have heard, that when you have inflation and you want to fight it, the interest rate has to be raised above the inflation rate - that is what we have done back in the early 1980s, for example. American consumer price inflation right now, is above 8%; that is why I picked a 9%.

How can the Treasury finance this? In theory, they could borrow another $1.3 trillion per year just to finance the interest on the previous borrowing; but that is almost certainly not going to be a viable option. If the Government were to borrow more just to pay the higher interest costs on its existing debt, you are going to have both supply and demand working in the same direction. The supply of loanable funds will be shrinking because of the Federal Reserve's actions, and the demand for loanable funds will be increasing because the Government is borrowing more just to pay for the old borrowing. That will drive interest rates even higher in both directions; that is a death spiral for the Government. Almost certainly, not all of it will be borrowed. What are the other options then? Well, spending decreases and tax increases will also play a role. The American Congress right now seems to want to spend more, but that is almost certainly not going to be viable. Spending decreases as tax increases necessarily mean recession, as resources are re-allocated to adjust to the change in federal spending.

How will this shrinking of the money supply effect banks in particular? Well, the banks will benefit from higher interest they receive on reserves, and they will also receive higher interest on all the mortgage loans that they are making-mortgage interest rates are already rising in the United States. However, on the other hand, banks will be harmed by higher long-term borrowing costs and mortgage defaults when the recession reduces household income. So, we probably will have some bank loan defaults in the recession, or maybe more bank failures during the coming recession. However, I do not think we will have the type of systemic risk that we saw in the Great Recession of 2008. That was mainly the consequence of bank 'runs' which occurred when depositors withdrew money from viable, otherwise solvent banks, because of concerns from the banking community. Banks do not lack liquidity anymore in the United States; maybe someone ingeniously - the Federal Reserve by paying interest on reserves at banks, has now built-up bank reserves to a point that they have trillions of dollars in cash that they can draw upon. So, **I think we will have some bank failures, but we will not have the type of systemic risk contagion that we saw before.**

Here are some tentative forecasts! US business failures will probably rise; perhaps in large numbers due to some combination of the following - so more failures, more insolvency, more work for insolvency lawyers. Because of higher borrowing costs, reduced government spending, higher taxes, and reduced consumer demand during the recession that we may already be starting into in the United States. We will have some US bank failures as well, although probably not as severe as the business sector, and we should not have the systemic risk problem, because of the way we have changed liquidity in the banking sector. Much higher yields on US Treasury debt will put pressure on foreign sovereign borrowers as well. If you are a foreign sovereign borrower and you are borrowing in dollars or you are borrowing in any other competitive currency, as the yield on US Treasury debt goes up, that will put more pressure on you to pay a higher yield on your own debt to be competitive in the local funds markets internationally. That is higher debt service and so there may be more defaults there as well. It is a gloomy picture I realise, although it may be good for lawyers.

So far, I have been talking about the United States, I have 3 things to say about another country, because I feel like I should say that we have an international crowd here. I know much less about other countries, but I looked at some basic data for the UK in honour of our hosts of the University of Leeds, and what I saw with this data was some very similar developments, so **I think the trends that I am talking about have international parallels and potential implications.** Here is a percentage quarterly change in the United Kingdom since about 1995 in GDP. This looks like, to me, a successful defibrillation attempt - you have a patient that is basically flat lined - if this is an ECG on the table, and then you defibrillate and suddenly the heartbeat goes again. What this really is, is small changes with GDP going up in some years unlike the Great Recession where it is going down, and then suddenly COVID is unprecedented; GDP drops by 20% in a quarter in the UK and rebounds almost 20% up, a similar pattern to what we saw in the United States, although somewhat actually more accented.

UK Government debt, like in the United States, has increased as well; it is now over 100% of GDP. Doubtlessly, the UK Government spend heavily to bring about this EKG event to bring the economy back, but it has to mean lots more debts. So, the consumer price inflation - in the UK, the CPIH index - was high back in the late 90s, now it is high again; highest in 30 years. So, we are seeing price inflation in the UK as well. Eventually, will have to tighten to fight this. UK business insolvency going back 10 years - like in the United States, astonishingly, dropped initially during the COVID downturn, but unlike in the United States, are already starting to rebound. We have more filing, total company insolvencies, creditor liquidation, and so on, are rising already as well. In this way, **I think the UK is ahead of what**

we are going to be seeing in the United States. Those are my comments regarding the question; is it an insolvency pandemic for US? – So, the answer is yes!

Panel 1: Corporate Insolvency

Introduction by Oriana Casasola

Hello everybody. For those who do not know me, I am Dr Oriana Casasola, and I am one of the organisers of this Conference. I would like to thank everybody who is here for being here and I am really excited today because we managed to put together three amazing panels. I am also very proud that we managed to adopt an innovative 360-degree approach to insolvency. Today, we are looking at corporate insolvency, banking insolvency, and then at state insolvency- so to sovereign debt.

Just a little housekeeping before we go into the first panel, I would like to ask you if you are not presenting, you are not asking question, please keep your camera and microphone off. These panels will last 90 minutes; we are a bit late in the schedule at the moment, but I am sure we will manage to catch up. I would like to start with the first panel: the one that deals with corporate insolvency law.

Today we have Professor Sarah Paterson, she is a Professor of Law at the London School of Economics and Political Science, where she teaches and researches on corporate insolvency restructuring law. For all the speakers, I cannot list all the achievements they have had in their careers, but just to mention, that she has published a lot of publications. Amongst these publications, there is also a monograph that I would like to recommend; it is 'Corporate Reorganisation Law and Forces of Change' published by Oxford University Press.

From Sarah we will move on to Professor Stephen Madaus who is a Professor of Law at Martin Luther University of Halle-Wittenberg- I can pronounce it only because I have been there. He is Co-Chair of the Academic Committee of the International Insolvency Institute and a Founding Member of the Conference on European Restructuring and Insolvency Law.

Last but absolutely not least, we will hear from Professor Tibor Tajti who is Professor of Law at the Central European University, which is a Private University in Vienna, Austria. His primary field of expertise includes bankruptcy and secured transaction law and corporate governance, finance and security, and financial regulations.

The panel structure is that each speaker will speak for approximately 15 minutes, more or less, and we will have questions at the end of the three presentations. I would like to start with Professor Sarah Paterson, and I would like to ask you, Sarah concerning the European Directive on Insolvency Restructuring which was adopted in June 2019. It has triggered, in the last year, a lot of interesting debate. One of the debates that is currently in the limelight is Article 11 concerning 'cram down' and the test adopted. Could you please provide us with some framework on how cram down works in the UK and in the US, in particular with reference to the test that they adopt.

Presentation by Sarah Paterson

Thank you, Oriana, for such a warm introduction, for the plug for the book, which is gratefully received, and to everybody at the Centre, I am absolutely delighted to be here.

As Oriana has said, what I am going to look at is cross-class cram down in the US, the UK, and Europe. The thesis of the presentation is that we tend to think that cross-class cram down, as it has been very recently introduced in the UK and as reflected in the European Restructuring Directive, is a transplant or an import from the US. What I hope to show with my remarks is that the way that cross-class cram down is being implemented in the UK is very different from the US and provides a very different context for disputes in cross-class cram down cases. What I then want to show is that the European Restructuring Directive seems to me a little bit of a smorgasbord of both approaches; it has characteristics that are quite US-centric, and it has characteristics that are much more familiar in the UK context. That, I hope, will position us for Professor Madaus' presentation, where he is going to pick up, I hope, where I leave off.

So, starting with Chapter 11, and I think this will be familiar to most of the audience, but just a very brief bit of context. We are assuming that we have a restructuring plan, and we have put that restructuring plan to debate, and there are different classes of creditors who have voted on that restructuring plan. One class has dissented it and has not achieved the statutory majority, so we have got one entirely dissenting class where we have not achieved the statutory majority. I think most people in the audience will know, Chapter 11 famously has a mechanism for cross-class cram down. So, it is open to the court, subject to certain conditions, to impose the plan over the objections of that entire dissenting class. What I am interested in for the purposes of this presentation is: what factors does the court to take into account? Now, I am going to do a very deep dive into just a few very specific aspects- there are more things that would need to be considered than the things I am going to touch on here.

So, the best interests of creditors test is familiar. That is not specifically a cross-class cram down requirement. The best interests test essentially requires that, in order for the court to decide that this plan is fair, the creditors must be getting at least the amount they would get in a liquidation. What is important in a US context is that if we are asking the court to impose the plan over the objections of the entire dissenting class, two special distributional rules are implicated - distributional rules which would not apply if we had a consensual plan, in other words, if we had achieved the statutory majority supporting the plan in each class. Those two additional distributional rules are that: (i) the plan must not unfairly discriminate, and (ii) the plan must be fair and equitable- famously known as the absolute priority rule (or APR).

What I am interested in is what this means methodologically in a cross-class cram down case in the US. I am going to focus particularly on the second of those distributional rules, the APR. Effectively, what happens is that a single enterprise value is determined for the firm. That enterprise value is then distributed down the creditor waterfall. So, by that I mean, we look at the distributional order of priority in insolvency with the secured creditors at the top, and so on. We distribute that enterprise value down that waterfall and then we test the results that we get from that exercise and use that to test the fairness of the plan. We look at what everybody is getting in the plan, and we test whether what they are getting in the plan is fair when we compare it with distributing that enterprise value of the firm down the creditor waterfall. This idea of an enterprise value for the firm- that is going to be significant.

Cross-class cram down in the UK is really different - as recently introduced by the Corporate Insolvency Governance Act 2020 (CIGA). We have a new Part 26A restructuring plan procedure which also enables the court, for the first time, to sanction a plan over the objections of an entire dissenting class. We have had cram down within a class for a long time, but this ability to sanction a plan over the objections of an entire dissenting class is new. Our fundamental test of fairness is very different from the idea of a single enterprise value distributed down a waterfall.

What our court has to be happy about is that none of the members of the dissenting class would be any worse off if the court were to sanction the compromise or arrangement, that they would be in the event of the relevant alternative. The relevant alternative here is what the court thinks would be likely to happen if the plan were not sanctioned. That could of course be a liquidation- a breakup of the firm and a realisation of the assets. It could be quite similar to the best interest of creditors test, but it might not be. It is much more likely to be a going concern sale of the firm out of the administration. Indeed, that is considerably more likely, in most cases. So, it is more likely to be a going concern sale, but it may not even be that. We have had a recent case where the company tried to argue that it would be a yearlong wind down of the business. The court actually did not agree, they thought the relevant alternative was different.

The point that I am trying to draw out in a very limited period of time is that, in Chapter 11, there is of course the prospect of a valuation fight over what this enterprise value of the firm should be, that is distributed down that creditor waterfall. It is quite a clearly defined argument: what the enterprise value is. As all of you know, there is a huge literature on how you go about calculating that value; we are looking for that value and we are going to distribute it down the waterfall. Part 26A, on the other hand, is a much more open, contextualised debate. It is: what do I think I would get in the event of the relevant alternative? That is not limited to what I would get in a distribution, in a liquidation, or what I would get if you distributed the enterprise value of the firm. I can bring into the argument all sorts of other things that, as a creditor, I think, would have flowed to me in the event of the relevant alternative.

Now to try and show how different this is, I am going to use an example. I have taken this example from Baird, Casey, and Picker's article. They use the example of what they call 'topping off prepetition suppliers'- what do they mean by that? Well, what they mean is that a supplier has supplied the firm before their bankruptcy, and they are owed an outstanding amount. If the firm were to be sold as a going concern to a buyer, they would get whatever the distribution to unsecured creditors was. Say you sold the firm as a going concern, you get the value, and you distribute it. What they would get in the bankruptcy is the distribution to unsecured creditors.

But it is extremely likely, in many cases, that, in fact, outside the bankruptcy the purchaser will top them off. They will say 'this supplier is incredibly important to me and actually I am going to do a deal with them, and I am going to pay them in full, because I think they are really crucial to the running of the business.' Now Baird, Casey and Picker use this in their article to draw the contours of what they call 'the bankruptcy partition'. It is a fabulous article and we have not got time to do justice to it, but what they are really saying is that US bankruptcy is uniquely concerned with what you get from the estate. These things that happen outside the bankruptcy, are not part of the debate - what US bankruptcy is focusing on is the estate.

Now our relevant alternative blows that open, because our law simply says: 'what would you get in the event of the relevant alternative?' There is nothing in the legislation that says that you read that down to a distribution. And so, in this example, it is clearly possible an unsecured creditor would receive a distribution in the relevant alternative. But, if your argument is that any purchaser would also pay you in full because you are completely crucial to the business, then you can bring that into the debate. So much more open, contextualised grounds are available for a creditor to argue about the position they would be in, if the plan were not to be sanctioned; this is very different from the systematic way that this is done in the US, where the methodological approach is consistent from case to case.

Now, in my remaining 3 minutes or so, I am just going to lay the ground for Stephan, because it seems to me that, when we turn to the European Restructuring Directive, we find all of these different approaches put into the mix, a sort of big cauldron of these different approaches. Article 10 tells us the plan must meet the best interest of creditors test, but this goes beyond a pure liquidation analysis. No dissenting creditor has to be worse off than they would be if the normal ranking of liquidation priorities under national law were applied. That seems to be an enterprise value that we distribute down the creditor waterfall. But then we find out that it is not necessarily a liquidation on a breakup basis, it could be a going concern sale and then we also find the concept of the next best alternative scenario appearing at the end. We seem to have a mixture of an enterprise value distributed down a waterfall, mixed with a best interests of creditor liquidation type test, mixed with a nod and a wink at the next best alternative. It seems to be a bubbling cauldron of all the approaches.

When we get to Article 11, we find that the dissenting class must be treated at least as favourably as any other class of the same rank, and more favourably than any junior class. This is the famous European version of relative priority; you have to do better than the junior class, but it does not really give you any more guidance than that. And Member States can derogate and go for an APR. That again, seems to be a single enterprise value distributed down the waterfall and then we test whether we either do relatively better than a junior class, with very little guidance on what that means, or a Member State can choose to use an APR type approach.

When we get to Recital 49, we get a bit of a mishmash again: 'where the plan is confirmed through a cross-class cram down, reference should be made to the protection mechanism used in such scenario'. I have to say, I am still not very sure what that refers to. I do not really know what that means. Then we are told that 'where Member States opt to carry out a valuation of the debtor as a going concern, the going-concern value should take into account the debtor's business in the longer term, as opposed to the liquidation value'. That, I think, is a little bit confused, for reasons that I will just touch on very briefly.

The challenge that I sort of set for Stephan was: how does all this fit together in the Directive? I hope, that is where he is going to pick up. It seems to me a confluence of the UK approach, where the fundamental test of fairness is: how would you have fared in the event the relevant alternative (a much more open and contextualised inquiry) and the US approach where aspects of the fundamental test of fairness is testing the plan against distribution of the enterprise value down the creditor priority waterfall. There seem to be multiple exercises going on. Is the dissenting class worse off than it would be if the enterprise value of the firm on a piecemeal or a going concern sale was distributed? Or, if it is different, perhaps the next best relevant alternative? Then there is this question mark about Article 11.

Finally, there are lots of different concepts of liquidation value jockeying with each other in the Directive. Article 10 uses liquidation value simply to mean a sale. That could be a breakup sale, or it could be a sale of the business and assets as a going concern- so, it uses liquidation in an expansive sense.

Recital 49, on the other hand, draws a distinction between a going concern sale and liquidation value. It seems to assume that liquidation value means a breakup, and that going concern is something else. So, one of the things that makes it hard to interpret the Directive that liquidation value does not seem to need to be used in the same way. Recital 49, I think, slightly misses the point, with the greatest of respect to the drafters of the Directive. A going concern price always takes into account future value- a purchaser who buys a business as a going concern is giving value for the future. The salient distinction, I think, is really between going concern value in prevailing market conditions - which has traditionally always been the UK approach. We say, 'what would someone pay for this business today?';'What would someone give you as an unsecured creditor to top you off if they were to buy this business today?' – and the US approach, which has strained over many, many years to look more for, what I would call the 'intrinsic' or the 'fundamental' value of the firm- the concern that the purchaser will undervalue the business today, either because of the taint of bankruptcy, or because there is not much debt availability in the market, or because everybody is being very cautious because we are in a recessionary period, so there are bidders. There are, indeed, multiple reasons why the going concern value and prevailing market conditions might undervalue the firm. So, the US approach strains much more towards 'what would we get in normal market conditions for this business' and is very reluctant to see discounts added to the value to bring it back to the prevailing market conditions. That seems to me to be the salient distinction, and that distinction exists really between the dominant UK approach, which is the first one, and the dominant US approach, which is the second one. But it is, as I say, I think a little bit- it is confusing to unpick these things in the Directive and to see what is really meant by the terminology.

That is laying down my challenge for Stephan: 'how the approaches fit together in the Directive?' I have used the word 'right' perhaps somewhat provocatively, but 'what is the right approach to valuation?' that is really going on.

I am just going to finish with the two references. The first is the bankruptcy partition article, which I mentioned, for which I tried to draw that example of the difference in how you would treat the 'top up' amounts. The second is a working paper, which I have at the moment, which really explores these ideas in a great deal more depth- certainly between the US and the UK- more than I have been able to do today, but which I would be very delighted for comments.

I am going to stop sharing that, and hand back to Oriana. Hopefully just about on time.

Introduction by Oriana Casasola

Thank you very much for the perfect time keeping, perfect presentation; thank you very much for the clarity and the interesting points you raised. We can move, then, to Stephen- you have been challenged quite a lot today. Could you give us your thoughts on the new approach to cram down under the Directive, please?

Presentation by Stephan Madaus

Sure, I would love to. Maybe two things first for me to reply to the questions that Sarah left to me. First, if you look at the text of the Directive it is a text that was developed over the course of four years, and by many authors, eventually. You can see that some parts of the Directive were not modernised the same way; eventually, discussions were finalised in the final steps of the Directive. It seems like some corrections that would have been needed in light of last developments have not really caught up- so this is something that might explain that. The second is, there has not been a clear doctrinal or methodological approach to preventive restructurings; it was a discussion in the making, I will illustrate that quickly. And so, some of the inconsistencies are simply due to the fact that there is compromise; there is a huge amount of compromise that was necessary to come up with a harmonising effort at the European level, and this shows.

Okay, two sides of it: best interest test and priority rules. I would like to illustrate both of them quickly using a very small example, very typical example. So, imagine the mom-and-pop shop at the corner in financial difficulties, maybe due to COVID etc, so there is unpaid debt- mostly unpaid tax debt. There is now enforcement looming from tax authorities, otherwise the business is open and having positive cash flow again, but the unpaid tax is threatening to kill the business. The question is: ‘Can I restructure my unpaid tax debt? Yes, you probably can if your country allows for tax debt to be restructured, which now is the case in many European jurisdictions. The fact then is, if you come up with a plan that has the support of your other creditors but not the support of the tax authority, the tax authority will often not be present in proceeding, so you will not be expecting any positive exception of the plan by the effective tax authority.

You would always look at the protection tests that you will need to pass in order to have the plan confirmed anyway. The first protection is the famous ‘best interest of creditors test’, it originated in US law. The EU calls it the ‘no creditor worse off’ principle. It has since been implemented to EU law as well in the banking directives. It is also national law concept; it was known to German national law for a long time under the curtain of ‘worse off’ idea; it is the basic idea that if you are forced to accept a deviation from the nominal value of your claim, you are often guaranteed, at least in Germany and some European countries- even under constitutional property law, that you would at least receive no less than the enforceable value for claims, so the liquidation value of your claim, meaning the enforceable value of your claim.

So, how do you determine that? That brings us to one of Sarah’s questions. Well, there are different options to determine what is the enforceable value of the claim. The first one is a non-bankruptcy related definition; it is simply what you would achieve, how much value you would be able to generate on behalf of your claim if you were forced to enforce your claim individually? So, what comes out of a payment enforcement procedure under your local law? If you are a secure creditor, this would probably give you a protection of your fully secure claim but apart from that, you would probably not be able to have a 'going concern' sale initiated based on individual enforcement actions. The argument could be made, and that Janger makes together with Melissa Jacoby, is that the very lowest protection under a liquidation value, could therefore be something that would never include the going concern value of any business because you would not have access to the going concern value based on individual enforcement.

The second option, of course is different. The second option is to look at the liquidation value including, not only an individual enforcement, but also collective enforcement which brings us into the realm of insolvency. You could, as an individual creditor, at least in many countries, initiate involuntary bankruptcy proceedings based on your claim. So, there is a good argument to say: 'if that is one of my enforcement options, especially against an insolvent debtor, this is something that should be protected under such a test'. You could say 'it is simply the liquidation value in insolvency proceedings', you could also say 'wait a minute, insolvency proceedings do not have a single outcome anymore, it is no longer simply piecemeal liquidation. The outcome is different, that could be a going concern sale, there could be a restructuring or reorganisation plan'. Even what comes out of an insolvency proceeding is less than certain so the value generated in insolvency proceedings that you can initiate individually, is still a variety of things.

One could say it is all of that, you could say what is most probable scenario that is to be expected, of course, without the plan you are going to be bound, and this is the basic idea of the European Restructuring Directive: to keep it open. To say: we know it is all possible, we know the benchmark, so the counterfactual can be insolvency proceedings can be something out of court, so it is the alternative scenario as you describe it to the Court, as the most probable one. That could potentially also include a going concern sale, it could potentially also include competing restructuring plan, if you can paint the picture that the most probable alternative scenario is a competing plan and that the competing plan is to be most probably accepted by the required majorities. In Germany we do not do the latter, by the way, in Germany, the test would not include - under the current law at least- the proposition that there is a competing plan that is ready to be circulated, voted on, and then confirmed.

How did we get there, why did we get there? Well, the initial idea of EU legislator was to simply copy US law. There is the best interest based on bankruptcy liquidation Chapter 7 value and then there is an absolute priority rule. We even had some sort of legal transplant in Germany which worked, kind of, we did not really have many cases, but at least it was a legal transplant that was there for 20 years.

By looking at it, we found some reasons for unease, at least, and that is already present in the case I presented to you. First of all, 99% of all enterprises in Europe are small and medium sized enterprises, 93% of them micro-enterprises under the definition of the European Commission and they are responsible for 66% of all employment in Europe. So, most of our companies have very specific features, they have a simply concentrated capital structure and there is little to no market value of those businesses in distress. The best interest in any of those options was to protect at least preferred and secure creditors sufficiently in all of these cases. Therefore, there is not so much need for additional APR, especially with a view that any APR would see equity at the bottom of it, effectively giving a veto right against any plan that would see equity remaining in place. Equity would receive something which is more than nothing, which immediately invokes the APR in a way that you could not cram down the plan against any more senior creditor class, which would include junior creditor classes- including, of course, the tax authority.

We thought that if you have an entrepreneur who is also the sole shareholder of a small business, it would make the whole system not applicable to them, not attractive to them, because it would deter them from even presenting a plan as they couldn't be successful anyway. The same is even more true considering that most European Member States public creditors- the tax authority in particular, enjoy preferential status. You would give them even more preference, which means that they get a veto right, and in Europe they are prone to veto- at least to be passive, which would probably be the same as a veto. The idea was felt to frustrate any legislative initiative to involve public creditors in this type of burden sharing exercise.

So, what are the alternatives? The first alternative quickly mentioned, because I was a co-author of it, was a project of the European Law Insolvency Institute in 2018 which said: APR is good, but it has these two problems, so we should provide, at least, a directive which safeguards small businesses and safeguards against the veto rights of preferential creditors, that are not justified. We would call that a relaxed APR. APR, in principle, is fine, it is tested in the U.S., but we should make sure that it does not strictly apply to small businesses, at least to entrepreneurs who are also shareholders, and preferential creditors.

A different project eventually came up with the idea of a Relative Priority Rule which is essentially the idea that APR is still too absolute; more flexibility is needed in principle, so it is still a priority rule, but it gives a lot of leverage for a more equal distribution of value across the ladder down, including to equity.

So, the Directive eventually settled for a compromise which included all of these options that I described. There is the best alternative scenario which includes all sorts of options, there is an RPR- now as the default solution- and an APR- as the optional solution- there is the solution of the relaxed APR and Article 11(2). There is nothing for 'relaxed' treatment under the RPR but Article 12 offers shareholders equity- a special treatment which probably takes them away in some form from the strict waterfall that Sarah describes. There is even a provision that says that Member States are free to deviate from any APR or cram down provision for small businesses with an owner-management structure. So, we have more flexibility, even for those 99% of businesses that we see in Europe. There was a fierce debate whether this is the right way to do it. I remember in 2020, right before the pandemic hit, an Amsterdam conference with U.S. and Dutch scholars where they thought this was the end of corporate bankruptcy because we would deviate from priority principles too much. We were all curious to see how this would play out.

How has this played out so far in Europe? We see all of the options being used- the first example is Austria. In Austria, on the one side, we see a best interest test that strictly defines the alternative scenario as the insolvency proceedings outcome. The alternative scenario is the outcome of insolvency proceedings which could include a going concern sale, but which should not include an insolvency plan. It is more than the piecemeal liquidation value, and it is again more case sensitive than the U.S. approach as Sarah described. There is also full protection for fully secure creditors because in any type of liquidation, they would expect 100% of their claim being covered. Then there is the relative priority rule as we find it in Article 11(1)- no deviation from it, very simple, very strict. For shareholders, we have a special treatment under Article 12 and so, there is a relative priority rule and shareholders might not even fall under this waterfall. If there is a justified treatment for them, this might not give a veto right to the tax authority. So, it is a strict APR no exceptions there, but with options for the entrepreneur shareholder.

The very difference is the Dutch regime. I mentioned already that they were very keen on implementing a strict form of APR which they have done. So, the best interest test and it is the liquidation of the assets in the debtor's bankruptcy so it is very much similar to the U.S. test, but it might be more than piecemeal liquidation- it is case sensitive. If the liquidation of the assets and the debtor's bankruptcy results in a going concern sale that value would need to be reflected here. We have the absolute priority rule in a very traditional form with some very limited exceptions, including reasonable grounds for deviation, provided, however, that creditors and shareholders concerned are not harmed in their interest- whatever that means. Whether this is a walk away from any exception or not, that remains to be seen. We have minimum payment rules here for particularly vulnerable creditors and we even have an option for cash payment of the bankruptcy liquidation value. There is a lot of things that protect the APR even more than providing for exceptions.

So, there is an APR in a rather strict form, maybe in an even stricter form than we know in the U.S. A compromise we have implemented in Germany is that we have a best alternative scenario stating that creditors should not be worse off under the plan than they would be without a plan, which could include any best alternative without the plan as far as is sufficiently probable. This is not a new test for us; it was test that has always been a part of the German Insolvency Law as a transplant - a loose transplant- of U.S. law, and then we have the absolute priority rule, with very significant exceptions. We implemented the new value exceptions as we learned from U.S. law, and then there is better treatment- so there is deviation from the need to equally treat anyone on the same level, based on the fact that Germany has hardly any preferences in bankruptcy liquidation. Most of the creditors would rank on an equal level, so there must be a way to deviate amongst classes, if necessary- equity may retain value if it is essential for the success of the restructurings.

Overall, you see, Sarah, that the confusion that you see in the Directive is actually the confusion based on compromise with a view to open up legislative options. You can also see that European legislators have used these options in a variety of ways, and this is only 3. I guess once this is implemented, whatever the Directive gave them, you will see 27 very different implementations of what we have here as optional in terms of a best interest test and a priority rule.

Thank you.

Introduction by Oriana Casasola

Thank you very much, Stephan. Thank you very much for this presentation, it was super clear; almost as good as Sarah for timekeeping- but we have time, so it is OK.

Now, we can change the topic. We are not going to talk about cram down rules now so if you have questions, please save them to the end- after this presentation we will have time for questions. Now, Tibor will talk about general data protection. The General Data Protection Regulation was adopted in the European Union in 2018 and, it has been defined as the toughest privacy law in the world. It was implemented in also the UK in 2018. So, Tibor, could you please give us some insight on the impact of the Data Protection Act on insolvency law and insolvency practitioners.

Thank you.

Presentation by Tibor Tajti

Thank you very much for the invitation. I will talk about a different topic, and maybe from a micro-economy perspective. This is a living problem, which is a problem not just in the European Union, but I think it is a problem elsewhere. I know there are discussions already in Canada, some in the United States. I know from my Chinese students that data protection has become a big issue, just like insolvency in China as well. Therefore, I have chosen those aspects of this topic, which I named as 'Insolvency Data Protection Law Interplay'.

First, let me briefly provide you with the background: I will focus on European Union now. First of all, what has become common knowledge is that data protection law has become very, very important in the European Union. The European Union is proud that it has the first compact data protection law in the in the world. It is a model which has penetrated all fields of our lives-economy, etc, including also insolvency and bankruptcy law. During these last 22 years which represent the history of European Data Protection Law, many things have changed. Changes are pretty fast and as Oriana stated, the General Data Protection Regulation (GDPR) is the law which is presumably the strictest regulation in the world. It is a cold document; if you compare it to previous legislation, you will see that the GDPR is much wider with much more technicalities involved. Apart from that, we also had some developments in the world of insolvency law, because insolvency law could be said to be among the priorities in the European Union.

One could conclude that it is a priority not just on the basis of 2019 Preventive restructuring Directive that my colleagues have been talking about, but also the Recast Insolvency Regulation. The Recast Insolvency Regulation, which was passed in 2015, foresaw the introduction of a European electronic platform which would have been run by the European Commission, from the centre, where the idea is to link all the insolvency registers at Member State level to this platform at the European Union level. The idea is to make access to information about insolvency in the various Member States much, much easier which is obviously fostering backing up and its materialisation of the basic ideas of insolvency law.

When the data protection people, let me put it that way, saw that this new Chapter will be added to the Recast regulation, they immediately ranked the balance. This basically means exposure of personal data to more risks and therefore something needs to be done. Essentially, the answer was the addition not just of the European e-Justice Portal but also a new Data Protection Chapter which is pretty short and dictates the use of the general available data protection law. This also was another example that there are more and more situations where insolvency law and data protection law come into touch. There is some interplay and in certain situations even conflicts arise. The reason I am talking about this topic is because I wrote the comments on this new Data Production Chapter in the commentary edited by Professor Reinhard Bork and Kristin Van Zweiten and published by Oxford University press. Now we can think about the possible consequences.

What I am going to do in the rest of the presentation is to give you four very concrete examples, because I think that this challenge, this interplay, is something new and it is very hard to imagine the situations where data protection law may significantly interfere with the working of insolvency law. I have found four cases and I will present a very brief idea to show you that the interplay is something serious. In other words, insolvency practitioner should not sit idly by anymore. Seeing the growth and the penetration of data protection- that is one of the main lessons. Finally, because data protection law essentially involves constitutional law issues, human rights issues. In Europe, we have Strasbourg European Court for Human Rights, which has a peculiar relationship, also, with the European Union. It is not excluded at some point in time, exactly because these reasons, even the Strasbourg Court may come up with a decision which may directly affect insolvency law and insolvency practices. This, I admit, is a very remote risk, I will not talk more about it.

The simplest case- I got this case from the Hungarian Data Protection Authority when, a few years ago, they were still willing to cooperate with me as a Senior Professor. From 2011/2012, one liquidator kept lots of documents containing personal data, which is the main object of data protection law, in an unguarded and unlocked stable- where the horses were kept, somewhere in the back. The Hungarian Data Protection Authority somehow learned about this and simply went out and fined the liquidator with 5 million forints which is roughly about 16,000 euros. A simple case but it tells insolvency practitioners that data protection authorities can knock on your door at any time. They have to learn how to deal with and implement data protection law.

Then I found an interesting case from Germany, this is more about secured transactions law, which is very closely linked to insolvency law, as we know. In this case, the issue was about priorities, primarily. As you can see, the debtor was a doctor of psychotherapy who went bankrupt and was about to be liquidated. The most important assets of this debtor were the unpaid invoices- so, the receivables. The issue came up that the liquidator turned to the owner and said- 'please hand over the invoices' so that he could make the debtors pay. The debtor refused, thus invoking data protection laws, saying that 'these contain personal data which are protected by European Data Protection Law and therefore I cannot give it over to you'. The issue for the Court was to somehow resolve this conflict- if we can call it a conflict. Eventually, the Court sided with the liquidator and said that 'the invoices must be handed over to the insolvency practitioner'. Amongst the reasoning there was contained a very important line which was that 'there are actually some techniques, whereby even in some situations, the personal data can be protected'. So, the lesson from this case is that similar priority related cases may also emerge because of the interface.

The third one, a big case from the UK, before the pre-Brexit period, but I think that the lessons that could be drawn from the case are still valid, not just in the UK, but also elsewhere in Europe. This *Southern Pacific Personal Loans* case 2013; the simple story is that this company was pretty big, had a subsidiary which collected various kinds of personal loans related to data- so, also containing personal data. The company went bankrupt. Liquidation was opened, two liquidators were appointed, and they began the work. During the proceedings, two big problems emerged which I think superbly show you know the seriousness, the significance of the conflict between the two branches of law. One of them was when liquidators are controllers for the purposes of the European Data Protection Law? This is an important issue, because under Data Protection Law, you have two main participants: one of them is the controllers and the other one is the processors. The processors are the technical people, IT department, etc who also have responsibility and liability, but the controllers are the ones who decide, and therefore their responsibility and liability is the highest. The big issue was whether the liquidators are the controllers for the purposes of the Data Protection Act. The outcome is kind of interesting because the UK board basically said that they are not because the company can perform the functions of the controllers, which was in my understanding, a little bit strange and maybe not necessarily in line with the data protection laws.

The second one, which is the illustration of the impact of data protection law, namely during insolvency data protection law must also be implemented. What I have tried to show here is the concrete data. The liquidators, soon after opening the bankruptcy proceedings realise that there will be problems with processing the request filed by former debtors of the company because on the basis of data protection law, they have a right to access the data. The liquidators made the computation that, in order to satisfy this very simple technical request, it would cost about £500 per person, annually that costs quite a lot. They made an estimate of total liabilities of about £10 million. The estate is roughly worth $3 million and then, every year during the liquidation proceedings, the data protection regulations will eat up £500,000 of the estate. So again, there is the outcome from all these things but the case, to me, was a real eye opener because it showed the interplay, meeting of these two branches of law is not a simple thing, and not just a rarity but rather something that one should really reckon with more seriously.

Finally, the last case which I found from Italy. The essence is that certain types of assets which otherwise have commercial value- in this case these are biotech. The biological samples and the related documents which are all saleable and which have higher and higher value on the market. Given the fact that it was confirmed by the EU Commission, that the biological samples "are able to reveal information which refer to an identified or identifiable person and hence, are protected as personal data". This came as a novelty, to the UK company that acquired Italian LTD Holding which possessed genetic data about the Sardinia region of Ogliastra, if I pronounced it correctly, where most of the centenarians live in the world.

So, this is what the cases have revealed to me, and the question is, what should we expect? To me it is clear to me there will be more and more cases; interferences need to find the proper balance. I am not really certain that that the European Union is paying sufficient attention to these problems. The concrete example which I would like to add and finish my presentation with is that, if you take a look at the text of the new Data Protection Chapter in this Recast Regulation, you will see that the European Commission, or whoever was drafting the text, have forgotten to replace the old data protection legislation with the GDPR which is enforced now.

Thank you very much.

Closing of Panel 1 by Oriana Casasola

Thank you very much for this presentation. It was very clear and, of course, I agree with you, Tibor, that it will be increasingly important in cross-border corporations how we manage this data from the debtor.

Panel 2: Banking Insolvency

Introduction by Virág Blazsek

Thank you very much Oriana, you set a very high standard; I greatly enjoyed this first panel discussion. The second panel discussion will follow a similar structure, two thirds of the time, we are going to spend on the panel members delivering their remarks. Then, we are going to spend some time on a debate and the Q and A. In this second panel, we are going to focus on the financial sector - banking insolvency, it is a little bit narrower and a more specific topic as compared to the first panel. We have three excellent panel members from three different corners of the world.

Our first speaker, Mr Mario Tamez works at the IMF as Senior Counsel - at the Financial and Physical Unit of the Legal Department of the International Monetary Fund. He joins us from Washington DC. Previously, he worked as a Director of Central Bank regulation at Banco de Mexico, and also, at the Mexican Financial System Stability Council (CESF). He has various decades long experience, and he also took part in designing the Key Attributes for an Efficient Bank Resolution which he will introduce in greater detail in his talk. Secondly, we will hear from Aurelio Gurrea-Martinez who joins us from the Singapore Management University. He will also discuss a little bit about what they are doing at his very active research centre. Aurelio is also a member of the Academic Steering Committee of INSOL International, and he is also the Director of the Ibero-American Institute for Law and Finance. He also holds various other positions; he has a lot of energy. I really admire his contribution, and most recently, the research service of the US Congress actually cited his research, regarding dual-class shares.

Our third speaker, Julia Suderow is going to join us from Spain, from the University of Deusto Faculty of Law. Julia's specialisation is Competition Law, Private International Law, and International Trade Law, and she also has a very active professional life. Amongst others, she is the founding partner of 3C Compliance that aims to provide compliance advisory services to companies. She is going to highlight a little bit what Competition Law, market concentration, and financial consumer protection development really means for financial stability, because in this panel, we are going to focus on financial stability.

With that, I invite our first speaker, Mr Mario Tamez to deliver your remarks.

Presentation by Mario Tamez

Thank you very much for the invitation! I will provide the international perspective on these topics. I will start with a caveat; my views do not represent the IMF, the Board, or its management. I just want to stress that the objective is to present, from an international perspective, the work that has been done, and shed some light on the potential use of resolution frameworks. The key takeaway is that banks are complex financial entities with particularities that deserve careful consideration while developing and implementing resolution frameworks.

Important progress has been made regarding the core functions of an effective resolution framework for the banking sector. Circumstances vary, but some general principles should apply, so therefore it is important to learn from the previous experiences. However, there should not be a one-size-fits-all approach.

What is the rationale of resolution regimes? Banks are exposed to numerous shocks, for example, COVID, oil prices, weather, or climate events. Shocks may also be present at the same time. What characterises a systematic crisis? Systematic crises are highly destructive events affecting a wide range of economic activities, with longstanding effects, typically generating large burdens on taxpayers. So, the State needs to be involved. Financial crises are usually associated with a loss of confidence in banks - that can morph into 'bank runs' - but they can also include stock markets crashes, the bursting of asset bubbles, and sovereign defaults. Every crisis is different, but there are common elements; there is no universal playbook for crisis management. The strategies need to fit the specific circumstances, local laws, and local practices; cross-country experience offers important guidance. I think that this links with our previous panel; the difference between the objectives of the typical insolvency features, and the problems if we apply this type of regime to banks.

Corporate insolvency aims to provide the value maximisation for the creditors. However, when facing these types of systemic crises, we might face situations where financial stability might be at stake. So, the objective would be to safeguard financial stability and protect depositors. In connection with governance, insolvencies are typically court-based. In the case of problems applied to the bank, we need to have a speedy solution and the ability to assess the public interest objectives of financial stability. These are better done, usually, by an administrative public body. Corporate insolvency places an automatic moratorium on all the liabilities; however, this may render deposits inaccessible and therefore, it will affect the payment systems and the whole economy. In connection with funding, in the case of corporate insolvencies, short-term funding needs might be more limited. However, banks have an enormous short-term funding need, for example, depositors will need to do have access to their own funds so, therefore, public backstop might be needed. This often pushes governments to bail out the banking system, but this could create a lot of fiscal expenses and moral hazard.

Resolution regimes aim to safeguard the continuity of critical functions that the banking system offers, minimise the adverse impact on other financial institutions, and avoid a domino effect to minimise the disruption to the payment system and settlement systems. They also minimise the adverse impact on the whole economy. **Safeguarding financial stability and protecting retail depositors should be the valued principle. Therefore, losses should be allocated to shareholders and then creditors**; in any case, avoid unnecessary loss of value whenever it is possible. Also, moral hazard and taxpayer support should be avoided when possible.

The Key Attributes (KAs) for effective resolution regimes were adopted by the Financial Stability Board in 2011. In 2014, the KA's were supplemented with sector-specific Annexes. In 2015, the 'Cross-border Effective Resolution Actions' were also published. In 2016, the Methodology for Assessment, the implementation of Key Attributes to the banking sector were published too. This methodology was intended, primarily, for the following uses: first, assessment by the authorities for their own regimes, also, the use of the resolution regimes is coordinated by the FSB framework, in addition the IMF and the World Bank have incorporated these KA's as part of the assessment of the resolution regimes. In this context, in 2017, the methodology for the banking sector was endorsed by the IMF Board to be used in the context of financial stability, Financial Sector Assessment Programs and reports on that core observation code.

What is the purpose of the KAs? They set the core elements that should be considered, that are necessary for an effective resolution regime. Their implementation should allow resolving financial institutions in an orderly manner, without taxpayer exposure to losses. The core issues are in maintaining the continuation of the vital economic functions that banks provide. So, the next question is: what should be the scope of resolution in this context? Any financial institution that could be systemically important or critical if it fails. For the Key Attributes to work, it is relevant to underscore what there are preconditions. In that context, well-established a framework for financial stability: an effective supervisory system of regulation on oversights of banks, effective protection scheme for depositors, robust accounting and auditing disclosure routines, and a well-developed legal framework and judicial system, are warranted. Resolution practices should be applied in proportion to the depth, size, structure, and complexity of the banking system. Therefore, the assessment should consider all these elements and, in particular, the relative systemic importance of each sector and the market environment of the jurisdiction that should be assessed, methodology to increase awareness in adopting of clear institutional arrangements, broad and sufficient powers to act promptly, and the need to have preparedness; recovery and resolution planning is key, and cross border resolution too. These are the relevant elements of a framework for financial stability.

As we can see, the Key Attributes are quite comprehensive; they go from "scope" to "information sharing", "resolution planning", etc. In this context, the Key Attributes advocate for a resolution authority that should be operationally independent from political and industry interference. This resolution authority should have available resources and sufficient expertise to undertake the resolution actions. It should also have access to sufficient funding, and the authority should have sufficient legal protection. In this context, different jurisdictions have followed different approaches. In particular, some Central Banks or supervisors might be assigned resolution functions, however, in some bigger jurisdictions; usually a specialised resolution authority is assigned with these activities.

Let us move on to the resolution powers. One of the key resolution powers - and it is actually the one that is usually used, is 'purchase and assumption'. This is the ability to force the sale of all or part of the assets of the failing bank business to another willing institution. This sale helps to ensure both operational and financial stabilisation, the rapid auction of a package of assets and liabilities of the businesses. Some assets and liabilities may be excluded and therefore liquidated. The loss-absorbing liabilities are also excluded, but gaps could remain; some resources might need to be allocated. One of the biggest problems that we might face is the lack of appetite of the system to purchase the assets and liabilities that the bank that is undergoing financial stress, is selling.

Another tool is the 'bridge bank'. This is a temporary public bank that acquires the assets and liabilities where no private bank can be found to enter into the purchase and assumption. This should only be used in exceptional circumstances and for systemic banks. Bridge banks are operated with a full banking license and typically subject to prudential regulation and should be subjected to a specific timeframe. What are the key advantages? It maintains the value, while assessment is being performed, and the Bank is marketed for prospective buyers. This is useful for complex and large banks. The concerns are that there is possibly unfair competition with other institutions, the excessive time in the State's hands, risk of political interference, and costs may be increasing.

Another power that has a lot of attention is the 'bail-in'. What does bail-in mean? This is statutory power to impose losses on shareholders and creditors, without having to liquidate the original legal entity or transfer assets and liabilities associated with third parties, either through conversion of term deposits, subordinated debt, equity, or haircut to current value of liabilities. What are the key advantages? It is an effective resolution mechanism for large and complex banks whilst supporting the continuation of business operations. It avoids complexity of transferring assets or liabilities. However, it also poses several concerns, many problems may be faced when being implemented. Implementation of bail-ins is complex, and expertise is limited. We have only seen this type of scheme in a couple of jurisdictions; it is hardly tested in practice. Issuance of sufficient loss absorbing liabilities is needed to support the implementation, so it needs to be prepared. Intersection with security regulation is quite relevant, so there are a lot of parties that you will be also taken into account. What will be the situation with a security regulator, suspending, cancelling of shares and disclosure to the market? There should also be a need for compliance with a fit-and-proper criteria for new owners. There is likely litigation by bailed-in parties and possible contagion to debt holders in other banks given that they will also be subject, or could also be subject to a bail-in.

The above-mentioned problems should be balanced with safeguards. The safeguards are designed with two different perspectives: one, mechanisms to protect the rights of shareholders and creditors. In this context, as it was mentioned in the previous panel, respecting the creditor hierarchy, but deviation from the pari passu principle in public interest, when financial stability is at stake, the non-creditor worse off than in liquidation. So, it should be a control factor assessment that the creditors will be at least in an equal situation in resolution, compared to liquidation. Respect remedies, but these remedies should not constrain, limit, or delay the resolution actions. There should also be mechanisms to facilitate resolution in this context; courts cannot and should not reverse the resolution measures - but monetary compensation could be granted in case of damages. The early termination rights should be limited and legal protection - different to immunity - for the officials involved in resolution.

Bank resolution regimes provide options to deal with the failure of banks, while maintaining the continuity of critical functions and avoiding the use of public funds. International standards and best practices can guide national frameworks but need to be tailored to their specific idiosyncratic situations of each country. Adequate resolution tools, underpinned by legal safeguards are key for an effective resolution regime.

Thank you very much!

Introduction by Virág Blazsek

Thank you very much, Mario, for this fantastic overview of the bank resolution regimes in general, which were implemented differently in each and every jurisdiction. I know that you have extensive experience regarding developing countries, so there are so many questions to unpack here.

Now I invite Aurelio, our second speaker, to hold your talk, please. I forgot to mention in the introduction that Aurelio was based in the US and in the UK at top law schools, such as Harvard, Columbia, and Stanford, or the University of Oxford. Aurelio, if you can please also talk briefly about your research centre.

Presentation by Aurelio Gurrea-Martinez

I would like to start by thanking Virág and the University of Leeds for the invitation to this fantastic event. It is very flattering, and it is an honour to be in such wonderful company. I have to confess that it is always very challenging to speak after Richard Squire, Sarah Patterson, and other leading scholars in this area, but I will do my best. In fact, I have more questions than answers, but hopefully, those questions can lead to an enriching discussion after my presentation.

Regarding Virág's question, the Singapore Global Restructuring Initiative is indeed a project launched by Singapore Management University with the support of the Singapore Ministry of Law with the purpose of promoting cooperation, awareness and cutting edge research on corporate restructuring and insolvency. Even though we have mainly focused our research on corporate insolvency law, the COVID-19 crisis has encouraged us to analyse the relationship between corporate insolvency, bank insolvency and a sovereign debt crisis. For that reason, I would like to congratulate the organisers for putting together this fantastic programme. I think that it really captures what many regulators and policymakers are thinking about when they address the economic and financial challenges raised by the COVID-19 crisis.

I will start my presentation by providing a general background of the Asian context, about how bank resolution works, and what are some of the interesting and, probably, some of the main divergences that we observe between Asia and other parts of the world. I can see that we have many colleagues here from Asia (or with a research interest in Asia), so it would be great to hear their views on this exciting topic.

I think it is important to start by speaking about the rationale and limitations of bail-in regimes as a new mechanism for bank resolution. Additionally, it is important to analyse why many countries around the world, also in Asia, have adopted bail-in regimes. Is it because it is indeed economically desirable, or just because it has become popular? As Mario mentioned, the economic reasons behind the adoption of bail-in typically include saving money for taxpayers and preserving financial stability ex-ante and ex-post.

Ex-ante, the shareholders know that they will be automatically wiped out, even though in bankruptcy, they will probably face the same problem. In bankruptcy, however, they may have more leverage for negotiation, more bargaining power. In fact some countries (particularly those where the absolute priority rule is not strictly respected), they can even get some value out of the corporation. With bail-in regimes, shareholders and certain creditors know that they would be automatically wiped out in the event of insolvency. That is supposed to create more incentives ex-ante to monitor the bank, the performance of the bank, the management, and the level of risk taking. Therefore, it is supposed to be beneficial for the stability of the bank and the financial system from an ex ante perspective.

Ex-post, so once you manage the whole resolution process within days (as it typically occurs with the new bail-in regimes that have been adopted in many jurisdictions around the world), the bank failure is less disruptive for the stability of the financial system. Therefore, from an ex-post perspective, bail-in regimes can also promote financial stability by minimising the loss of going concern value and reducing problems of contagion, lack of confidence, and systemic risk. Again, these are the traditional economic arguments. I am going to play the devil's advocate here. So I want to challenge whether these arguments are really powerful enough. Thus, **we will be able to determine whether countries are adopting bail-in regimes because they are economically desirable or just because it is an international trend or something recommended by some international organisations.** As we will see, sometimes international organizations may have certain markets and institutions in mind. However, something eventually beneficial for some countries might not work in other legal and institutional environments.

Let us discuss a bit more what happens in Asia. To that end, I think it would be useful to start by looking at this table that I show here based on a study by Standard & Poor's (S&P). It shows something very interesting because it says that people in Asia and the Pacific are relatively supportive of bailouts. Something that is probably quite shocking for Richard and for some of our colleagues, mainly from the US and in the UK and Europe. In other words, the study shows that **Asian countries have a relatively good attitude toward bailouts**, especially when compared to their European and American counterparts. So why (if so) is this attitude found in Asia?

I would like to discuss three potential hypotheses. The first one is that **Asia has many state-owned enterprises (SOEs).** This is probably surprising for many people in the US and the UK, due to the fact that SOEs are rare in US and UK capital markets. If we look at the reality in Singapore or in Hong Kong - needless to say China - many of our listed companies are actually SOEs. This table that I am showing is based on a very interesting study conducted by Adriana de la Cruz, Alejandra Medina, and Yun Tang from the OECD. For those interested in corporate governance and corporate ownership structure, I think that this study is really fascinating because it analyses corporate ownership around the world. The study shows that SOEs are very common in many Asian jurisdictions, including Indonesia, India, Malaysia, Pakistan, Mainland China, Hong Kong, and Singapore.

If we translate that into the specific banking sector, we can also see that some of the largest banks in Asia are also SOEs. In fact, a Singapore-based bank that is one of most innovative banks in the world (DBS) is an SOE. India is one of the Asian countries with more SOEs in the banking industry. Other banks controlled by the state can be found in Indonesia, China, and many other Asian economies. This is relevant because it may affect the likelihood of a bailout. In some countries (particularly emerging economies with weak institutional environment), a bailout can be decided based on political interests. In countries with strong institutional environments, such as Singapore, the likelihood of a bailout will probably depend on an economic assessment of the situation and what is best for the stability of the financial system.

If we look at the bank failures in Asia, particularly in China and India, many banks have been bailout. Interestingly, bailouts have even been observed in Asian countries with bail-in regimes. However, this is not only an Asian fact. It was also observed in Italy with the bail-out of Banca Monte dei Paschi even when Italy already adopted a bail-in regime. That reminds me to what Professor Squire told me about 7 years ago: bail-in regimes are not credible enough, and governments will continue to bailout banks. The problem is exacerbated when, as it has been mentioned, the bailout is not based on a sound economic analysis but just on political interests.

A second hypothesis to understanding the Asian attitude towards bailouts is what Mario mentioned, that is, bail-ins have their own limitations. The first one is credibility, the point mentioned by Professor Richard Squire, and also by Professor John Armour in a fantastic paper that he wrote several years ago (‘*Making Bank Resolution Credible*’), where he emphasised some of practical problems for the successful implementation and credibility of bail-ins. If these problems are not solved from an ex-ante perspective, it is not going to be credible, and that is why the ex-ante beneficial efforts of a bail-in regime might not even exist. One of the successful cases of bail-in regimes in Europe has been Banco Popular in Spain. I say that is was successful because it was managed within days. However, the case has been criticised by many people because it raised certain concerns from various perspectives, including valuation and transparency. The shareholders of Banco Popular have been challenging the resolution of the bank but the Court of Justice of the European Union recently held that the resolution process was properly conducted.

A bail-in needs to be managed very quickly and relatively confidentially so it can avoid bank runs, loss of going concern value, contention effects and other disruptive effects on the financial system. Thus, it can preserve financial stability ex-post. However, the speed and confidentially can reduce credibility and transparency. Also, they might not lead to a competitive bidding process where the insolvent bank can be bought by the highest bidder. Therefore, these factors can be detrimental ex ante. On one hand, they can discourage shareholders and subordinated debtholders from investing in a bank, leading to an increase in the cost of capital for banks. As a result, it can even lead to less capitalised banks, undermining the solvency and stability of the bank and the financial system as a whole.

Also, when it comes to the resolution of a financial institution, there are many issues regarding independence and expertise of the regulators that will affect the credibility, efficiency and effectiveness of the process. To that end, it should be noted that, with the exception of Canada, the United States, Europe, Australia, New Zealand, Hong Kong, Singapore, Japan, South Korea and a few others, the rest of the economies around the world are emerging countries. Unfortunately, most of these countries suffer from problems of corruption, and sometimes lack of resources or expertise to effectively handle complex issues such as the resolution of a financial institution. These problems undermine the desirability of bail-in regimes in emerging economies. Finally, there are also some cross-border issues that may hamper the efficiency and effectiveness of the resolution of financial institutions.

All these factors can undermine the credibility, effectiveness and efficiency of bail-ins, not only ex post but especially ex ante. Therefore, **the second hypothesis potentially explaining the Asian attitude towards bailouts is that many Asian countries do not believe that a bail-in regime is necessarily desirable**. If so, the interesting question is **why many countries have indeed adopted a bail-in regime.** Potential explanations may include market pressure, or the fact that it is recommended by international organizations or adopted by many jurisdictions around the world.

The third hypothesis to understand the Asian attitude toward bailouts is that maybe some Asian countries are willing to pay the costs of the bailout in order to get more financial stability. If we compare the benefits of bankruptcy, bail-in and bailouts in terms of financial stability, a bailout is the best mechanism to promote financial stability even if it is the worse one for taxpayers and preventing moral hazard. Ex post, a bailout may reduce the disruptive effects of a bank failure in the stability of the financial system. Ex ante, it can create more confidence and even reduce the cost of capital for banks. As a result, the costs for taxpayers and the moral hazard problem may be price that some Asian countries are willing to pay. Additionally, certain Asian countries have adopted other measures to reduce the likelihood of bank failure or at least reduce the harmful effects associated with a failure. For example, Singapore requires more capital requirement than those suggested by the Basel Committee. This factor, along with the strict supervision of the financial sector by the Monetary Authority of Singapore, may contribute to the existence of a more solvent and resilient banking sector.

Of course, other alternative explanations for the understanding of Asian towards bailouts is that the fact that certain Asian countries, such as China, are not full democracies. Therefore, even if part of the population is unhappy with a bailout, they will not complain as they do in other countries around the world. Yet, even if this explanation can partially explain the Asian attitude towards bailouts, there are some economic reasons to be sceptical about bail-ins, especially in emerging economies with weak institutional environments.

Therefore, why not exploring other mechanisms to promote financial stability in a more desirable manner? For example, various scholars have suggested that controlling shareholders may be held liable for the bank's debts. That would encourage controllers to closely monitor managers and make sure that the bank does not take significant risk. Of course, this solution may also create other undesirable effects – particularly ex ante. Yet, it is an interesting proposal that deserves further analysis.

A few years ago, my colleague Nydia Remolina and I argued that the tax benefits of debts should be abolished in the context of financial institutions, and equity financing should receive a more beneficial treatment. Thus, banks would have more incentives to raise equity without being exposed to the often costly rules suggested by the Basel Committee. This idea has also been suggested by other scholars around the world, and various empirical studies analysing the adoption of tax benefits to equity in Belgium supports our intuition: this reform can lead to more capitalised firms. Therefore, this is another mechanism that can be adopted to promote financial stability.

Other mechanisms to promote financial stability may include more supervision and stricter corporate governance rules. As the 2008 financial crisis showed, part of the problem can often be found on the compensation schemes of directors and executives. If banks should not ideally take significant risks, executives of financial institutions should not ideally be paid using equity-based compensation. Some authors have been exploring the use of debt-based compensation schemes. Other forms of compensation based on sustainable growth, rather than short-term performance, can also be explored. Other corporate governance mechanisms such as the scope of directors' duties and liability of banks, the composition of the board, and the empowerment of risk management commitments, can help reduce the level of risk-taking of banks and therefore the stability of the financial system.

Other solutions can include contractual mechanisms. In the context of corporate insolvency law, contractual solutions have been debated mainly since the 90' – especially after the publication of a very influential paper by Professor Robert Rasmussen. While these contractual approaches to deal with corporate insolvency have not been adopted in practice, they have actually been used in the context of bank resolution. Namely, a recovery and resolution plan ("living will") is way to explain how a bank will deal with a potential situation of insolvency. Therefore, it is not that different form the pioneering idea suggested by Rasmussen. Exploring these contractual approaches further, including the improvement of living wills, can also be a mechanism to discipline banks ex ante and promote a better resolution of financial distress ex post. As a result, they can also contribute to the stability of the financial system.

Finally, let me conclude by briefly referring to another interesting solution that has been recently suggested to deal with bank insolvency in a more efficient manner. Namely, Professors David Skeel, Thomas Jackson and other authors have argued that ordinary bankruptcy procedures, bailouts and bail-in suffer from several problems. But what happens if the ordinary bankruptcy system is adjusted to deal with bank insolvency? This is what they have suggested: the creation of a new chapter of the US Bankruptcy Code (the "so-called Chapter 14") to deal with insolvent banks. This proposed Chapter 14 for the US Bankruptcy Code would provide some of the advantages of using the bankruptcy system (e.g. reducing costs for taxpayers, addressing moral hazard, etc) but minimizing the costs of this mechanism by amending certain bankruptcy provisions that can be detrimental in the context of bank failure (e.g. treatment of derivatives and other financial contracts) and adopting certain provisions from the current bail-in regime.

Given this whole range of solutions, what is the most desirable approach to promote financial stability? I do not think there is a universal solution – once size does not fit all. Countries have different market and institutional environments and each jurisdiction may require a different strategy. However, a combination of ex ante measures incentivising the capitalisation of banks (for example, by abolishing the tax benefits of debt and favouring the use of equity instead) and reducing the level of risk-taking (e.g. by adopting corporate governance reforms more suitable for banks) and exploring new ways to deal ex post with insolvent banks can be a good starting point. But I wish I had the solution to this puzzle. That is why I very much look forward to hearing what everybody thinks about this fascinating issue.

Thank you so much for your attention, and I very much look forward to the discussion.

Introduction by Virág Blazsek

Thank you so much, Aurelio! Fantastic, I have learned so much! I am giving it over to you, Julia, immediately. Just a quick note, that Julia also has a very international background. Although she did her PhD at the Carlos III University in Madrid, she studied at the University of Louvain, and in Hanover too. Julia, over to you - you are going to teach us a little bit about some recent developments in Spain, and what effects they might have on financial stability.

Presentation by Julia Suderow

Thank you so much for this kind invitation. I am a Competition Law expert, I am not a Banking Law expert, but I will try my best from this perspective, not of the taxpayer, but the perspective of the consumer and the consumer welfare. This is the main idea behind this presentation. We will see what has happened, in my view, in Spain after the financial crisis. I am not going to talk about the restructuring in Spain. I am going to talk about what happened as a consequence of the restructuring in the market in Spain. We will see if it has had a positive or a negative effect on consumer welfare and in general, on the Spanish society. As we all know, Spain was one of the main countries affected by the financial crisis in Europe. One of the main reasons is that we were overbanked, like the UK, before the 2008 crisis. This means that we had lots of banks everywhere. Everywhere you looked in a Spanish city you found bank branches from different providers and different bank institutions. On the other hand, we depend a lot on real estate, and we had a very high debt on the state level, and also on the private level. So, in 2008, we had a very severe crisis and the banks suffered a lot. And from that situation, we started to trying to restructure everything, particularly with the support of the European institutions, and the result is something that I will try to present today.

Well, we know that, and this has been studied by the OECD and the European Commission and by the European Central Bank, it happened, also, in other countries of the world that the financial crisis - one of the solutions in fact, promoted by the restructuring of all the financial institutions was that, at the end, we had a bigger concentration. This means less providers of the services, less banks, bigger banks that are more solvent, that are more solid, that are able to maybe cope with future crises. On the other hand, we have less competition in the market - this is one of the main consequences. And we will try to show it through the case of Spain where we see that these effects may be quite severe.

The Spanish banking system was supported by the Bank of Spain, as you all know, and also by the Spanish Executive Resolution Authority (formerly known as Fund for Orderly Bank Restructuring) (FROB) - started in 2007-2008. Virag has a brilliant summary of all the history of our restructuring in Spain in her book. I am not going to go into the details, but it is still taking place. The last movement was mentioned by Aurelio, talking about the recent judgment of the Court of Justice of the European Union, from the 5th of May, 2022. The judgment that says that shareholders in the case of Banco Popular will not see a penny from Banco Santander, nor support from the Court of Justice of the European Union. So at the end of the day, lots of this litigation is still taking place, we see that they will not see any type of compensation for what happened in 2016. And, in 2020, we had a very big merger, between CaixaBank and Bankia - they were two very big banks already that absorbed a lot of all these failed banks and saved banks from after the crisis in 2008-2010, and so on and so forth. At the end of the day, we have five financial institutions in Spain that have a market share of around 80-90%, depending on the area of Spain. This means that we have moved from a situation with more than 80 or 90 institutions; we now have less than 11 big institutions and from that 11, 5 have 80% of the market share - in some regions they have even more. We are noticing this, not only from the simple perspective of competition law, but also noticing this the perspective of the services that are being provided to consumers. We will show it to you in the example of 'access to cash'.

You can see here all the legal, legislative instruments that we had in order to cope with this restructuring in Spain. This is just for you to have the information, it is not relevant at all for the presentation or for the ideas that I will try to explain to you. I just wanted to highlight the following: we passed, as I said before, from over 80 institutions to 11. This makes a massive difference when it comes to services in cities, when it comes to access to insurances, when it comes to access to cash, when it comes to all the financial services that are provided on the day-by-day business to consumers. In 2017, Mr Jose Ignacio Goirigolzarri, you probably know him, he was a very important bank manager and figure in Spain, he was the Chairman of Bankia and he has been playing, always, a very important role in Spain. He explained that we now have 72% - now this is even higher in 2022. This means we are now in 2022, around 80% or maybe more, and all of these mergers have been authorised by the EU's BRRD and also by our competition authorities on a national level, and with the support of the European Commission. So, all these movements have been authorised, this has to be said before, but now we see the consequences. **We may have authorised part of these mergers in order to be able to, to keep the bank alive, which was very important from the taxpayer perspective, but the taxpayer is also a consumer**. Now the taxpayers go into the bank and the bank is saying, 'well, you are only allowed to go to the front desk from nine o'clock in the morning until 10 o'clock in the morning' - you only have one hour to go to the bank and solve your businesses. This may be an issue for instance, for elder persons, for people that work, so on and so forth, or even for people who do not want to use the internet services that are provided by the bank for any type of reasons - there are still people that are not completely digitalised, as we all know. We will see what this means in practice, day-by-day in Spain.

It is also important to highlight that we have an issue with horizontal shareholding, and horizontal shareholding has been always a problem from a competition law perspective. Every time we have horizontal shareholding - this means that one shareholder has participation in several competitors or in different competitors, so competition is being reduced. This has an effect on innovation, on consumer welfare, on the prices that are being paid by consumers. This is quite important to say: if you have only five big banks in Spain, they will share shareholders, sooner or later, because the shareholders have to invest their money somewhere, and they will have to invest it also in Spain in Spanish banks. Although, the story that we had in the past, and sooner or later they will have common interests, and this means that competition will also be reduced on a very high level. There is a brilliant paper of Professor Einer Elhauge of Harvard explaining all these problems from the perspective of horizontal shareholding. **The European Commission has started to work again on horizontal shareholding, but we still see that in the case of the banking industry we tolerate it, probably due to the crisis and also due now to the COVID-19 situation that we are still facing. This is posing problems from the competition policy perspective because we are relaxing competition in several areas.**

A few minutes before we started the conference, I read that Mr Mario Draghi, who is a very big competition law defendant that we all know, has said that we may need a kind of purchase cartel in the case of energy. This was very surprising, like saying this in public and also talking about this with Biden, who is also very big fan and a defendant of antitrust - you see we are living now in a very confusing situation, at least for people that defend competition law in all types of situations. You see that there is a limit, and maybe the financial crisis was one of those limits. But, we can also learn for the future if we see the effects in places like Spain.

What you see here on the chart, is the degree of banking concentration, you see the yellow line has been marked by myself - this is for Spain. You see that it is highly concentrated compared to the situation before, and you have to think that in other countries of Europe, the concentration of the main players is maybe around 40-50%, which is already very high. This can already mean that we are in an oligopolistic situation. In the case of Spain, it is nearly 80%. This means, while we are very far, nearly doubling the medium - the whole European Union.

You see here what happened over the years, and you see that this was not something limited to 2008. It is something that just took place a few years ago and it is still taking place. You see the results, Santander, BBVA, CaixaBank - and CaixaBank just merged in 2020, together with Bankia, as mentioned by Virag in her brilliant study. It is one of the big cases where shareholders filed lots of claims, taking into account misleading information, where you can see, also, the conflict of interest that has been mentioned by Aurelio and Mario. We all can see that the taxpayer could have had a very bad ending if we had not supported the bank with instruments in the case of Bankia. You have to take into account that the criminal case is still taking place and we will see what happens in the end. Sabadell is quite a small institution, if you compare it to the result of CaixaBankia, which is CaixaBank and Bankia. You have to think that all those savings banks (“cajas”) before that had a social objective too; they were really there for savings and for smaller savers, and now they have all disappeared - nearly all of them. Now we have a few big banks, and a few savings banks that are still around on a regional level, for instance, here in the Basque Country, where I live. Okay, they are still there, but with limitations.

We can see that merger control could have been influenced by regulatory measures. What I tried to say is, **every time we think about the future, as mentioned by Professor Squire, and by Aurelio and Mario, it would be very interesting to also have a look into Competition Law in order to see if it plays a role, and how we can cope with all the different aspects and take into account consumer welfare as well.**

Now, I am going to show you an example of ‘access to cash’. Access to cash, is now such a problem that we will have to adopt regulatory measures. We come from a situation where, as I said before in 2008, we had several banks everywhere, everywhere we looked. And now, we have a situation where you have thousands of municipalities in Spain, where you do not even have a bank. There are some provinces and lots of municipalities where you only have one bank. This means the bank has a monopoly there. We also have obviously, as you all know, new businesses in the digital environment, they are doing a lot, and we also have banks that try to solve the problem of 'access to cash' through cooperations; for instance with supermarkets, with postal services, or even with our lottery services. So, I do not know what this will mean for the reputation of a bank, if you put the same office together with a lottery - I do not know, we will see what happens. At the end of the day, the National Lottery still plays a very big role in Spain and is spread everywhere. Maybe it is a good idea from a marketing perspective, but on the other hand, we will see what happens.

We also see that the use of a of cash has been reduced, from 80% to around 35% in Spain right now. But, if you go to certain regions of Spain or if you go to a certain part of the population of Spain, which is the older part of the of the population, you will see that they still use cash for nearly everything. You still have here businesses, they ask you for cash, you still have your landlord, they say the end of the month, maybe for tax purposes, I do not know, they say 'I want my money in cash'. This means you still have to go to the bank. Taking into account that, for instance, here in Bilbao, if you want to have the services of an international bank, the only international or European bank that still has bank branches in Spain is Deutsche Bank. This means that now, you have to take the car and drive for 20 kilometres [12.4 miles] to find the office. This means taking the car, so on and so forth, and your possibilities as a consumer are being reduced on a month-by-month basis.

We will see that obviously, we have come from a situation where we may have had too many offices, but right now, in some places, competition is suffering a lot. You can see the numbers and, this has been developed by a study that was presented a few years ago - already two years ago, by the Catalonia Competition Authority, because in Catalonia, this problem is quite a big concern in certain municipalities. They have to also broaden the CaixaBank also absorbed lots of smaller institutions that were already existing in Catalonia and so now, they have a very important, if not dominant position in certain areas as we will see. And, ATMs have been reduced all over the country. You can see here the number of ATMs from around 60,000 have been reduced to 40,000 and this is increasing on a day-to-day basis. If you take into account that each of these five banks has a different ATM system, this means that in some places, if you go to the bank, you will be forced to pay in order to have access to your money. If you go to your bank, and you go to the ATM system of your bank, you probably do not have to pay to have access to your money. In all the other places, just to let you know for people that are maybe not from Europe, you will have to pay 2-4 euros in order to get 100 euros out of your own bank account. This is in Spain, something quite new, and I do not know if we will get used to that.

In some of these municipalities, we also have a situation that we already call vulnerability. This means that people that are older, that have less access to the internet, particularly in places where this type of people live, all of the bank branches have disappeared, making the problem even bigger at the moment. These are places, obviously in Spain with less population - places with less population are probably the older people that are staying there, and the others went to the bigger cities, or whatever. **At the end of the day, these people have been discriminated against in a higher manner, due to not having enough people there to pay or to support an ATM. This may have an economic reason behind it, and this makes sense, but on the other hand, you are excluding these people at a higher degree than people in cities; this is quite important, in my view.**

And now, coming from this perspective, we are trying to solve this problem. On the one hand, through regulatory measures that are obliging banks to open ATMs again, or to provide alternatives, even with mobile ATMs to try to reach regions or municipalities that are not so well populated. On the other hand, we are trying to investigate what is going on in the market, there are several investigations that are taking place by the competition authorities in Spain, particularly by the national ones, that are related to some potential conduct that took place during the COVID-19 crisis that would have been impossible in the past. Like asking not only for combined products, but also using, so to say, the B2B power that may be in place, or limiting the access to COVID-19 aid that was provided through the banks to the client. To companies saying to them, well, if you want to have access to getting financial support and you get a bank guarantee that is issued by the State, then you can have access to credit. The banks also use, obviously, this opportunity to sell other products related to their normal business. So, this is under investigation at the moment, and you notice that this is only possible when you have a stronger position, so to say.

We are also noticing that other related markets are also affected. Life insurance - around 80% of life insurances are being channelled through banks, and are being controlled by banks in Spain. We still have in other in areas, for instance, this was traditionally a problem that caused very intensive litigation in the first 10 years of this Millennium, and it is also still causing big litigation. When banks in Spain provide mortgage and financing to a consumer to buy a house, they say, ”*well, I am going to give you this financing, but only if you buy Life Insurance - if you buy this insurance, and if you buy Home Insurance*.” This obviously has been considered abusive under certain circumstances. All the banks have changed the products, but they are still trying to keep all this connected market relations through their offers to clients. This means that connected markets are still suffering a lot - not only insurance, but also other areas. This is leading now to problems that need to be solved. **These problems can be solved through supervision by the competition authorities.** This will end probably with sanctions - we will see if these sanctions are effective at the end of the day, or not. And, on the other hand, we are also observing other measures, like these financial regulatory measures that I mentioned before, to change certain aspects, and to say to them - well, if you are closing, you are still a necessary service for society. In these type of situations, you will have special obligations to work towards consumers, and towards vulnerable people like elderly people.

So, the main message is that now we see in Spain at the moment, in 2022, the results of the regulatory measures that we adopted 14 years ago. **We see that we need stronger banks for financial stability, on the one hand, but stronger banks mean that they will have more power, and if they have more power, maybe consumers also suffer more. Therefore, there is more need for stronger consumer protection frameworks.** This is the main conclusion of my presentation.

Closing of Panel 2 by Virág Blazsek

Thank you very much for these excellent, thought-provoking presentations! Over to you, Karina.

Panel 3: Sovereign Debt

Introduction by Karina Patricio Ferreira Lima

Hi everyone, welcome to our sovereign debt and insolvency panel. I am delighted to be chairing this session, especially at a Conference that shares experiences and expertise with insolvency scholars. I believe this is an area where sovereign debt belongs. All areas covered in this conference are not self-containing but quite interconnected. Also, there is much we can learn from insolvency law to both make sense of and solve sovereign debt crises in a way that is efficient and fair. This is a very timely discussion because—due to the most challenging longer-term effects of the pandemic, the war in Europe, and monetary tightening by core central banks—we are facing debt crises in the global South. This is risking a two-track recovery in the global economy where inequalities are exacerbated.

Today, I have the pleasure of welcoming a stellar panel of three brilliant speakers, from both the scholarly and policy communities, to discuss structural reforms to address this threat of a lost decade for vast segments of the world's economy and population.

Celine Tan is a Reader in Law at the University of Warwick, where she is the Co-director of the Centre for Law, Regulation and Governance of the Global Economy (GLOBE). She joins us from Coventry, UK. Celine is a founding member of the International Economic Law (IEL) Collective, which is a community of scholars and practitioners interested in critical reflection on the interactions between law and the global economy. She has published extensively on issues relating to the law and governance of the international financial architecture, sovereign debt, climate change, sustainable development, and the role of international financial institutions and human rights.

Richard Kozul-Wright is the Director of the Division on Globalization and Development Strategies of the United Nations Conference on Trade and Development (UNCTAD). He joins us from Geneva, Switzerland. He has worked at the United Nations (UN) in both New York and Geneva, and published widely on economic issues at top international economic journals. He has also written a number of books, including his latest book, 'The Case for a New Bretton Woods', co-authored with Kevin Gallagher and published in late 2021.

Matthias Goldman is a Professor of International Law at EBS Universität in Wiesbaden, Germany. He is a Senior Research Fellow at the Max Planck Institute Heidelberg and co-editor-in-chief of the German Law Journal. Matthias has published extensively on sovereign debt, public international law, constitutionalism, financial regulation, money and banking, and the intersection of all of these with human rights.

Just as we did in the previous panels, each panellist will have around 15 minutes to present, followed by a Q&A open to the audience that I will be moderating. We will start by first hearing from Celine, who will tell us about the current debt landscape in the global South and how she expects the situation to evolve.

Presentation by Celine Tan

Hi everyone. Thank you for organising this panel, I am really pleased to be here and seeing so many people who are still very much engaged at this time.

I do not really have much to say about the sovereign debt crisis that people do not already know. There is currently a serious sovereign debt crisis facing the global South, but this crisis is not new. Although the debt crisis has come about on everybody's radar now, for those of us who are working in the area, it is never gone away. We are still dealing with the same issues since the 1980s; it is almost like the same solutions are coming back forward. While the landscape has changed, the players have not changed, the actors have not changed, and the issues have not changed. It is almost a little bit like Groundhog Day.

There are three things I want to say about the current debt crisis in the developing world. First, this is a systemic and structural problem. It is not something that has just come about because a pandemic has happened, or a climate crisis has happened. Of course, the problem been exacerbated by the pandemic and by the climate crisis, but it has always been exacerbated by some structural issue such as natural disasters. So, this is a systemic problem, a structural problem, and a dependency problem.

The reason for such problem is that it is historic. These are legacies of an asymmetrical system that has been shaped by colonial capitalism. The system is very much dependent on capital flowing in one direction and being controlled by certain actors, and has continued systemically and historically since the colonial period. There is a continuity there—it is about the power dynamics and who has voice within the corridors of decision-making power. It is not just about law. Once we go into the issues of sovereign debt, it is very clear that this is where the law and issues come about. In an academic form, you cannot discuss the law, doctrines, and contractual elements without looking at the structural power that accompanies the system. It is systemic, it is historic, it is exceptional—but the state of exception has become the norm. In sum, before moving to the solutions, we need to understand the sovereign debt crisis as a structural, systemic, and historical issue that is not an exception. Rather, it is part of a process of dependency of the peripheral countries to the centre.

Significant amounts of income from the developing country are flowing back to the creditors in the form of a debt service, either in capital repayments or, in many cases, just the servicing of interest for those creditors. In addition, there is now a multiplicity of creditors. There has been a change in the creditor profile of developing countries, with a significant amount of debt now owed to private creditors as opposed to official creditors, and that has changed the dynamics of the restructuring process for sovereign debtors. This compounds what is already a concerted problem in the global South, which is systemic, historical, and rooted in the dynamics of power. In not considering the features of this debt that match up to the profile of sovereign debt in the global South, the solutions to which we get are sub-optimal, not systemic. They do not address historical and contemporary asymmetries or the structures of power within those dynamics.

The current debt relief efforts and the current debt relief restructuring mechanisms are not optimal because they are very much reliant on so-called 'gentleman's agreements', dominated by certain actors within the corridors of power, and dependent on aid and charity. What you have is a debt relief system that is not based on agency, entitlement, or the variation of contractual rights in an equal negotiating power dynamic between two parties to the debt contract. Instead, the solutions are premised on philanthropy, aid, and the political power of those who hold capital. This situation reproduces the systemic problems and historical asymmetries of the system. I will give you the example of some of the things that you probably know.

The Debt Service Suspension Initiative (DSSI) was one of the proposed solutions of the G20 to address the acute problem of debt repayments during the COVID-19 pandemic. The

Initiative, which aimed to suspend debt service by low-income countries, was very much dependent on the goodwill of the creditors to be able to grant debt relief. Similarly, the Common Framework for debt treatments that succeeded the DSSI relies on negotiations between creditors in an informal forum of the Paris Club and within G20 creditors—it is based on individual negotiations. In many ways, that is the political wrangling—there is no insolvency process for sovereigns, and therefore no right to invoke sovereign bankruptcy to pull creditors to the table to renegotiate. Rather, this is a triage process based on custom, handshakes, and 'gentlemen's agreements'. This would be problematic for dealing with questions of contracts in a domestic jurisdiction. Why is it appropriate to deal with sovereign debt contracts?

Alongside the power dynamic produced by the lack of a legal right to restructure sovereign debt from a contractual standpoint, another aspect should be considered, and this is where the international community comes in. There is a strange relationship between development finance and sovereign debt, where public finance is being used to subsidise the asymmetrical structural problems and the regulatory failings of the international financial architecture. For example, we have things such as the Catastrophe Containment and Relief Fund (CCRT), which is mirrored on the different debt relief trust funds that the IMF (International Monetary Fund) has operationalised over the years, like the HIPC (Heavily Indebted Poor Countries) Initiative. These are trust funds which collect money from donors to then subsidise the difference between the repayments and the interests to be repaid or make the debt repayment on behalf of the debtors to the creditors—official creditors mostly. The International Development Association (IDA) does a similar arrangement with the debt relief mechanisms for commercial creditors. In practice, this is a different form of debt relief that does not involve a variation of the terms of the contract but rather the use of public money—donor money—raised through trust funds to repay creditors on behalf of the sovereign debtor.

Those arrangements are problematic because they rely on public finance to effectively subsidise the gaps and the regulatory failures of the international financial architecture. Alongside this, private creditors are not bound by any of the official debt restructuring or debt relief mechanisms and have not participated, for the most part, in official debt restructuring for insolvent countries. As a result, insolvent countries are left with sovereign debt bonds that must be repaid. How do they do that? Everybody knows it—through the IMF, that is, public money. Again, this is a subsidy from public finance that is diverted due to structural problems of sovereign debt governance.

In sum, the current problems are structural and historic, and the solutions do not deal with those systemic issues. In fact, they do not deal with any legal issues—it is just the use of aid and public finance to subsidise regulatory gaps. If people are interested, I wrote a paper called 'Shifting Sands: Interrogating the Problematic Relationship Between International Public Finance and International Financial Regulation' that addresses the argument I have made in this speech, although it probably needs some updating. The solutions have always been throwing good money after bad, and not necessarily for the betterment of the communities that are at the sharp end of it.

Introduction by Karina Patricio Ferreira Lima

Thank you so much Celine, this has been a thought-provoking presentation. I think it links quite well with what we will hear now from Richard.

Richard, you recently published the book *The Case for a New Bretton Woods*, which deals with Celine's point on the need for structural reforms in the international financial and monetary system. In a nutshell, why do we need a new Bretton Woods to structurally correct the challenging debt scape of developing and emerging nations?

Presentation by Richard Kozul-Wright

Good evening to everybody. As a Bradfordian, I am sorry I cannot be there in Leeds—it is always nice to go back home for whatever reason. Celine has done a lot of the heavy lifting. I agree with much of what she said—thinking of the problem in systemic terms is critical.

The staggering figure to keep in mind is the rise in the global debt stock over the course of the last 40 years from around USD 16 trillion in 1980 to around 300 trillion, according to the Institute of International Finance (IIF). This is a staggering increase in the volume of debt. Most of it relates to public and private debt in advanced economies, but also developing countries have become increasingly dependent on debt for their growth dynamic. It is important to remark that debt is an incredibly useful tool in the development process. There is a tendency to demonise the debt story, but all countries need to be able to use debt effectively to generate a long-term sustainable growth path. The tragedy of the current era is that this increase in the debt stock has not done what the proponents of private debt have insisted, which is to encourage productive investment. Productive investment over the same period has either been stagnant or indeed falling in many countries, both North and South—with some exceptions, of which China is the most important. To a large extent, this voluminous increase in debt has not led to a virtuous circle in which higher product, higher investment, higher productivity, and rising incomes have been at the centre. Unbundling the reasons for that is incredibly important for understanding where we should go next—this is a systemic issue, as Celine rightly insisted.

She is also right to suggest that this is not how much the international financial architecture thinks about this problem. Having just come back from the IMF meetings a couple of weeks ago in Washington, that is quite apparent to me. Georgieva—the managing director of the IMF—insisted that we are in a crisis-on-top-of-a-crisis. They recognise that sovereign debt is a particularly vulnerable point of that crisis and talk about change. In addition, World Bank president Malpass—I quote him—says that 'the world needs to have a resolution process for debt that is more robust than we have right now and starts earlier'. This is the kind of language that we have been using in UNCTAD for decades, that is, this is a system that delivers too little, too late.

Despite the rhetoric I heard at the IMF, the question is what they mean by that. Sadly, the discussion degenerates very quickly into not systemic problems, but bad apples instead. The two bad apples that appear now are, first, China as the new creditor on the block, and second, countries like Sri Lanka, whose debt problems are some combination of nefarious Chinese debt practices and bad policies. Neither of those are particularly useful ways of thinking about the problem. Of course, their solutions, when they frame the problem in those terms, go back to a set of familiar type of responses. These are that we need more transparency, improving bond contracts through collective action clauses, and strengthening the Common Framework. The Common Framework has not delivered very much at all and is struggling even to find countries that are willing to participate in it. There are only three countries that are part of it, and I think the only one that may be active is Zambia as they put together a creditor committee. When you listen to the discussions in the G20, in Washington, the International Monetary and Finance Committee (IMFC), or the Development Committee, they have no solutions. Even though it is apparent that these are failed solutions to the systemic problem, this is the only thing that they seem to be able to talk about.

As Celine said, this is not a new situation, nor can it even be pinned on the pandemic. Even before the pandemic, it was clear from 2012 onwards that a growing number of lower- and middle-income countries were either in debt distress or at high risk of debt distress. I think the IMF figure in 2019 was that half of lower-income countries (around 30-35) were already in that situation. In our 2019 Trade and Development report, we made the case that under current debt dynamics, the Sustainable Development Goals (SDGs) were simply undeliverable in many developing countries—the possibility of another lost decade was already apparent to us. Obviously, the situation since then has worsened. The pandemic led to further increases in debt—particularly public and publicly-guaranteed but also private debt—and there is no debt relief in sight. As Celine mentioned, the DSSI was pitiful compared with the scale of the problem that countries were facing. They were being squeezed fiscally as capital fled the countries, export earnings and remittance earnings declined, and currencies were under pressure, and the cost of borrowing increased. In sum, fiscal space was significantly squeezed due to COVID-19, and there has been no meaningful response from international financial institutions.

We were particularly worried in the middle of 2020 about the consequences of the global economic situation for vulnerable countries—in a certain sense, a lot of developing countries dodged a bullet in 2020 into 2021. Capital quickly returned to many countries, partly because yields available in the advanced economies were essentially zero or, in real terms, negative. There were opportunities for investors in emerging markets, and they were willing to take the risks. Commodity prices recovered more quickly than many of us expected in 2020, which helped a number of developing countries, and the dollar did not strengthen in a way that could have been particularly damaging for countries when it comes to external debt.

Yet the dodging of the bullet in 2020 and 2021 has become exposed as a consequence of the third crisis in the space of a decade or more—the war in Ukraine. Not only does the war have an incredibly damaging impact in Ukraine, which goes without saying, but also on developing countries that have little to do with the conflict itself. Food, fuel, and borrowing costs have already started to rise quite significantly in a number of developing countries. We are seeing the consequences of that, Sri Lanka being the first, but certainly not the last. There are countries in Central America and sub-Saharan Africa that are almost certainly going to topple—although many of the payments are probably not due for another 18 months, there is clearly very serious stress. In North Africa, the combination of those factors is leading not only to economic distress, but also serious political discontent. There are vicious circles emerging around declining economic circumstances and increasing political unrest—this is a particularly dangerous combination, as we know. The international financial community has very little to offer in terms of responding to the kind of systemic crisis that we are now seeing. Coming out of Washington, it was particularly disturbing to see how exhausted the international financial institutions seemed to be in terms of response.

What we would we like to see—which relates to your question, Karina—are alternatives to this very tired set of cliched responses that we hear from the international financial institutions.

Sadly, there is no real magic bullet, but many things that we are proposing should be much more visible and under discussion than they are. One is the more effective use of Special Drawing Rights (SDRs). We obviosly welcomed the USD 650 billion issuance of SDRs last year. But the problem is that SDRs are allocated on a quota basis, which means that countries that need them the least get them the most. The difficulties of recycling SDRs from countries that do not need them to those that do is proving extremely difficult. Given that SDRs are a non-debt-creating source of liquidity, we need a way of being able to use them more effectively. I think there is justifiably a lot of excitement around SDRs, but there is still need of thinking about tying the debt problems to the climate problem.

Debt for nature swaps have not really worked. They have been around since Costa Rica issued the first debt for nature swap in the late 1980s. However, we need to find a way of linking debt and climate in a way that delivers scaling up and consistency more effectively. UNCTAD and other institutions are beginning to think harder about that. An option that is emerging but not sufficiently scaled up are regional solutions, including not only for short-term but also longer-term lending. We have seen new institutions emerge at the regional level over the last 10 years—think of the New Development Bank, the Asian Infrastructure Investment Bank, and the scaling up of the Development Bank of Latin America (CAF). They tend to be much more sensitive to developing country needs than the existing multilateral regional institutions, but their scale is limited. Those are certainly mechanisms that need to be looked into.

In terms of the debt story itself, UNCTAD does not believe in the market-friendly solution to debt crises. Instead, it has offered at least two options. One is a soft law approach of principles that sovereign debtors and creditors adhere to in their lending and borrowing practices—UNCTAD has its own set of principles for responsible borrowing and lending. We were also involved very closely with Argentina in devising a set of principles on sovereign debt restructuring that was passed by the UN General Assembly in 2015 (UNGA Resolution 69/319). These have been ignored by the advanced economies and international financial institutions but, strictly speaking, are part of the international architecture on these issues. We think there is more to be done with that kind of approach.

Ultimately, we believe that some kind of statutory approach is needed to deal with sovereign debt restructurings. We need a Sovereign Debt Workout Mechanism (SDRM) that is not controlled by the IMF or the World Bank—they are creditors and, therefore, have a vested interest in solving problems in one particular direction. Instead, we need an independent mechanism. We had a meeting with Gopinath and raised both the principles and the SDRM with the IMF. Of course, they dismissed those proposals as being politically out of the question and argued that members will not consider them, and therefore they should be ignored. Ironically, Krueger, who comes from a very different political background from Gopinath, wrote a piece in Project Syndicate three days later reminding people that back in 2000-2001, the IMF serious canvased the idea but was dismissed by the United States. Something along those lines remains, at least for us at UNCTAD, the only way of dealing with the debt burden that perpetually keeps countries at the periphery of the global economy in a neo-colonial position, as Celine said. That is where we think far more emphasis, research, and support needs to be channelled.

Introduction by Karina Patricio Ferreira Lima

Thank you so much, Richard. There is an interesting dynamic between your presentation and Celine's.

Matthias, you have worked together with UNCTAD during the golden time of recent proposals for a structural solution to sovereign debt crises. Since the approval of the UNGA Resolution 69/319 in 2015, it seems that this issue has been fading from the policy, academic, and international community debate. Do you think we need a new momentum for the post-Global Financial Crisis (GFC) academic and diplomatic initiatives that took place until 2015? Do we need a new momentum for such initiatives amidst the economic effects of the pandemic, monetary tightening by core central banks, the war in Europe, and the climate crisis?

Presentation by Matthias Goldmann

Thanks for giving the floor and inviting me. I will try to offer a more positive stance on the problem, even though I fully share many of the insights of Celine and Richard. The major reason why I am a little optimistic is that debt restructuring has always followed major geopolitical trends—or geo-economic trends, if you so want. If we consider the geo-economic trends of our current period, much speaks in favour of a mid-term change towards better debt restructuring. To explain why this is so, I will take you through the five paradigms in sovereign debt restructuring over the last one and a half century. In no more than 10 minutes, I will present a sketch with a very broad brush of what I think are the major features of each paradigm.

The first of them is the <u>market paradigm</u> that began at some point in the 19th century, when sovereign debt became a major issue, and ended with the First World War. The market paradigm postulated that states should not be involved in sovereign debt or lending to developing and emerging economies, mostly in Latin America and Asia. At the time, this was not seen as a issue for politics. This market doctrine, which was deeply ingrained in developed countries, meant that politics only rarely played a role. There was some role for politics in countries where Western empires—mostly European—had a specific interest, like Turkey or Egypt. For example, the Ottoman Debt Administration, which was established in the 1880s after the Ottoman Empire became insolvent, was totally run by creditors. Effectively, this was just a means of controlling the Ottoman Empire—but that was an exceptional situation. The same goes for gunboat diplomacy—although some countries faced gunboat diplomacy, on the whole, politics took a backseat as this was not considered a major strategic interest in most cases.

The market paradigm was followed by the <u>enforcement paradigm</u>. After the First World War, it was clear that sovereign debt would be a major security risk, so it had to be contained. But it had to be contained in a way that debtor states were put in the position to pay back their debts. Different institutions emerged that sought to adopt this enforcement paradigm, particularly the League of Nations. The League of Nations established a committee to advise countries on how they could best adopt austerity policies and implement fiscal policies that would create creditor confidence. That involved, at times, debt restructurings, like in the case of Germany. Ultimately, the point was to enable states to repay their debt. There was still the idea that debt is a commercial contract, and these commercial relations should be kept intact. If we keep them intact, then we can achieve peace; so, let us make every political effort to keep things intact and keep the system running. After the Second World War, this is basically what the Paris Club has done. It was not about granting debt relief—in fact, it has not granted debt relief until very late in the 1980s. It was just a system of bilateral creditors that, in coordination with the IMF, should assist countries in meeting their debt obligations.

That changed with the end of the Cold War, which is when the development paradigm emerged. At that point, the idea was that, in order to have liberalised global market, it was important for financial markets to function smoothly. Countries should be resolvent and able to repay their debts. At the same time, the pressure from the Cold War on ensuring that countries were not left alone was failing, which meant that countries had to be self-reliant. For that reason, several multilateral initiatives were adopted to give countries a fresh start. These started with the Brady bonds and continued with the Highly Indebted Poor Countries Initiative (HIPC), followed by the Multilateral Debt Relief Initiative (MDRI). In the 1990s, as a result of the proliferation of private creditors, sovereign debt litigation started to increase, but at that period courts were very restrictive in granting creditors their right to enforce their claims against debtor states. They made exceptions, for example, to ensure financial stability. Overall, a state had not so much reason to fear courts.

A new paradigm change took place in the early 2000s, at the beginning of the Bush administration. At that time, the IMF's initiative to create an international debt restructuring system failed. Financial liberalisation gained so much power that it became untenable for politics to push through the idea of making countries self-reliant. Dependency on financial markets grew significantly, giving rise to the litigation paradigm. This period culminated in the *NML v Argentina* case in 2012, which was a dispute between the Republic of Argentina and the investor Paul Elliot Singer. Since the aftermath of the GFC, however, there has been a small change in trends. For example, in 2014, an investment panel in the case *Postova Banka* against Cyprus decided that sovereign debt was a special case, and it should not be treated like a private case. Once the financial crisis hit, the idea of public interest came in, at least in some cases. There has been a certain shift in tendencies. We see that also in Europe, where the European Court of Justice (ECJ) ratified the Greek debt restructuring. The Court even said that human rights should, at least in principle, play a role in the *Ledra* case and in another case concerning Romania, even though it has never been serious on the enforcement of human rights in the European debt crisis. Nevertheless, in principle, it has recognised the validity of human rights, and that is why I think that there is a chance that we get into a new paradigm.

I call that paradigm the sustainability paradigm. Richard and Celine have already poured a lot of water in the wine that I wanted to give to you. The background of this paradigm is that slowly, we begin to realise that healthy sovereign finances—and that includes debt restructuring—is crucial for key challenges. These include climate change, public health, migration, and security. Fiscal policy measures are crucial to prevent and remedy such challenges. That means that there needs to be a paradigm change not just sovereign debt restructuring, but also in fiscal policy.

Richard has mentioned some of the initiatives in the field of debt relief. While the DSSI adopted in the aftermath of COVID-19 was a good starter, we have not seen that much so far. The Common Framework—I am on the same page here as Richard—is insufficient. It is unclear how China will behave and what the role of private creditors will be in it. Also, the Framework only covers low-income countries, which means that middle-income countries are excluded from it. There is another ream of hope in certain initiatives at the domestic level. Some states are beginning to adopt legislation to restructure their debt, which means that they could unilaterally start initiatives to restructure sovereign debt.

By comparison, there are a lot of problems in the fiscal field. Interest rates are increasing, and certain political and market dependencies are created by public or private funding—you do not really know what you are getting yourself into. You can get bilateral debt or market debt; financial markets are still very powerful and there is no clear way to prevent that. Multilateral financing would be an alternative, but this poses the question of how much capacity would be available.

Nevertheless, the recent crisis in Ukraine speaks for a larger geopolitical shift. Even though the conflict is between Russia and Ukraine, a geopolitical dispute between the United States and China is somehow involved in the background. As cynical as that might sound, the more competition there is between different systems, the higher the chances that states have an incentive to behave as a 'good citizen' and adopt policies which will foster debt relief.

We have seen the worst of debt restructuring practice at the period when there was no geopolitical opposition and financial markets had a lot of power. Now, we see both trends receding. There is a growing global opposition, and at the same time there are certain tendencies to restrict market freedoms and to replace them by greater investing on the governmental side. This trend has emerged since the GFC and is reflected, for example, in the role played by state enterprises. These two factors combined may, in the middle or longer term at least, provide for certain hope that debt restructuring mechanisms will emerge more successfully or more effectively.

Closing of Panel 3 by Karina Patricio Ferreira Lima

Thank you so much, Matthias. This has been a very good way to finish these presentations, with a reflection on historical trends and some food for thought on how current developments may impact on the prospects of structural reforms.

Closing Remarks by Karina Patricio Ferreira Lima

On behalf of the organising committee and the Centre for Business Law and Practice (CBLP), we would like to thank Professor Richard Squire for his keynote speech, all the panellists for their presentations, and all attendees for engaging with this amazing conference today. I think this has been an extraordinary opportunity for a comprehensive and interconnected discussion of corporate, financial institutions, and sovereign insolvency, with a strong interdisciplinary approach. Not only has the conference connected different areas of insolvency law but also strongly engaged with the intersection of law, microeconomics, and macroeconomics. This has been an incredibly interesting discussion with the contribution of leading scholars and policymakers.

We hope this conference works as a platform not only for future events, but also for collaborations among participants across the world. We hope to see you soon in future CBLP events, as well as in other events elsewhere. Many thanks to everyone.