

GUIDELINES ON RESPONSIBLE SOVEREIGN LENDING AND BORROWING¹

Table of Contents

Part I: The Legal and Economic Rationale for the Principles	4
Purposes of the Guidelines.....	5
Characteristics of the Guidelines	6
Pathways to Implementing the Principles.....	6
1) Incorporation into rules of international law	7
2) Incorporation into domestic law.	8
3) Disclosure and reporting on the Principles conceived as best practices:	8
Challenges.....	10
Part II. Understanding the Principles	11
A. Interpreting the Guidelines for Lenders	11
Principle 1: Agency.....	11
Principle 2: Informed Decisions	12
Principle 3: Due Authorization	12
Principle 4: Responsible Credit Decisions.....	13
Principle 5: Project Financing.....	14
Principle 6: International cooperation.....	15
Principle 7: Debt Restructurings	15
B. Interpreting the Guidelines for the Responsibility of Sovereign Borrowers.....	16
Principle 8: Agency.....	16
Principle 9: Binding Agreements.....	17
Principle 10: Transparency	17
Principle 11: Disclosure and Publication.....	18
Principle 12: Project Financing.....	18
Principle 13: Adequate Management and Monitoring.....	19
Principle 14: Avoiding Incidences of Over-Borrowing.....	19
Principle 15: Restructuring	20
Part III: The Implementation of the Principles	21
A. Responsibility of Lenders	21
Principle 1: Agency.....	21
Principle 2: Informed decisions	22
Principle 3: Due authorization	22
Principle 4: Responsible credit decisions	24

¹ Preliminary Acknowledgments: We are extremely grateful to Matthias Goldmann for generously sharing his extensive collection of materials with us.

Principle 5: Project financing.....	25
Principle 6: International cooperation.....	26
Principle 7: Debt restructuring.....	27
B. Responsibility of Sovereign Borrowers	28
Principle 8: Agency.....	28
Principle 9: Binding Agreements.....	29
Principle 10: Transparency	30
Principle 11: Disclosure and publication	33
Principle 12: Project Financing.....	35
Principle 13: Adequate Management and Monitoring.....	35
Principle 14: Avoiding Incidences of Over-Borrowing.....	45
Principle 15: Restructuring	47
Summary and Conclusion	49
Glossary	50
Bibliography	52

Acronyms

BSP: Bangko Sentral ng Pilipinas (Central Bank of the Philippines)

BIS: Bank for International Settlements

CAC: Collective Action Clause

DESA: Department of Economic and Social Affairs of the United Nations

DMFAS: Debt Management and Financial Analysis System Programme

DMO: Debt Management Office

EBDM: Executive Board on Debt Management

IGCP: Agência de Gestão da Tesouraria e da Dívida Pública (Portuguese Treasury and Government Debt Agency)

IMF: International Monetary Fund

INSOL: International Association of Restructuring, Insolvency & Bankruptcy Professionals

MEC: Member of the Executive Council

MFMA: Municipal Finance Management Act

MTBPS: Medium Term Budget Policy Statement

NGO: Non-governmental Organization

OECD: Organisation for Economic Co-operation and Development

ODA: Official Development Assistance

PFMA: Public Finance Management Act

PPP: Public Private Partnership

SAI: Supreme Audit Institution

SDDS: Special Data Dissemination Standard

TDB: Trade and Development Board of UNCTAD

UN: United Nations

Part I: The Legal and Economic Rationale for the Principles

1. UNCTAD initiated the project on the Principles on Promoting Responsible Sovereign Lending and Borrowing (the “Principles”) following the global financial crisis of 2008. They are an innovative set of best practices for sovereign lending and borrowing. The Principles were produced by an expert group formed in 2009 and coordinated by the UNCTAD Secretariat.
2. The UN Secretary General’s 2010 Report on External Debt Sustainability and Development expressed concern over the consequences of excessive borrowing of developing and transition countries.² Since then, high levels of sovereign debt have also become a major concern in many developed countries as well. Recognizing the costliness of debt crises and the desire for increased stability within the international financial system, the Report called for rule-based procedures for sovereign debt, including an **early warning system, mechanisms for debt restructurings and greater transparency in sovereign debt transactions.**³
3. In sovereign lending and borrowing, domestic law take centre stage. As far as crisis resolution is concerned, the international community and debtor countries have generally resorted to commercial techniques, such as bond exchanges to resolve sovereign debt crises. Notwithstanding, responsible lending and borrowing is an international concern, given their cross-border effects ranging from financial instability over declining social cohesion to rolling back the gains from development and poverty alleviation. Persistent debt overhang and sovereign debt crises can set back progress towards the Millennium Development Goals and impair the ability of governments to provide public goods, including cross-country cooperation to deliver global public goods such as peace and a sustainable environment.
4. The Principles do not aim to directly change domestic or international law but **strive to durably change the behaviour of sovereign lenders and borrowers**, with a resulting shift in sovereign borrowing and lending practice. According to the Preamble, “The normative contribution of these Principles lies not in the creation of new rights nor obligations in international law but in **identifying, harmonizing and systematizing the basic principles and best practices** applied to sovereign lending and borrowing and in elaborating the implications of these standards and practices for lenders and borrowers at the international level.”
5. In particular, the Principles pursue three aims:

² Report of the Secretary-General, ‘External debt sustainability and development’, UN Doc. A/65/155.

³ Ibid., paras. 72–73.

- i. Provide a common conceptual framework on the law and practice of sovereign lending and borrowing
- ii. Achieve consensus on responsible practices in sovereign borrowing and lending and disseminate such knowledge
- iii. Create constituencies for implementation⁴

Purposes of the Guidelines

6. These Guidelines complement the UNCTAD Principles on Responsible Sovereign Lending and Borrowing by offering a practical toolkit for implementing best practices on responsible lending and borrowing tailored to the circumstances of particular countries. These Guidelines are designed to increase the understanding of and ultimately adherence to the Principles in order to strengthen sovereign responsibility in lending and borrowing and reduce the vulnerability of borrowing and lending countries to financial crises, and lessen the impact on creditors.
7. The resulting guidelines provide an overview of the Principles with the aim of bringing together the different parties to deals involving sovereign debt contracting under a set of consensual rules. This practical toolkit has been designed to help practitioners interpret and make use of the Principles. The following sections of part I offer guidance on the Principles and the practicality of their implementation. This part ends with the methodology of the Principles as a tool for professionals that are involved in the process of sovereign credit management, and offers a contrasted view of the implementation. Part II, covers the implications of the Principles for the current market practices. Where applicable, best practices used by sovereign lending and borrowing entities is put into context to show the origins and effectiveness of the relevant Principles. Finally, part III covers the framework and process of implementing the Principles. This last part is designed to help sovereign authorities and financiers in their efforts to apply practices that have been useful elsewhere. This flexible implementation process derives its efficiency from the capacity of the agents to adapt it to the particular circumstances.
8. These Guidelines are primarily addressed to those professionals that are involved in the process of sovereign lending and borrowing, for instance in DMOs. . In addition, the audience also includes other stakeholders concerned with debt sustainability, crises prevention and millennium development goals Their purpose is to offer a step-by-step guide as to how the Principles on Responsible Sovereign Borrowing and Lending could be interpreted and implemented.
9. The audience also differs by country. In some countries, DMOs are only marginally involved in debt sustainability analysis and loan contracting process. Their role increases,

⁴ Anna Gelpern, 'Hard, Soft and Embedded: Implementing Principles on Promoting Responsible Sovereign Lending and Borrowing' in Espósito C, Yuefen L and Bohoslavsky JP (eds), *Sovereign Financing and International Law: The UNCTAD Principles on Responsible Sovereign Lending and Borrowing* (Oxford University Press 2013), 3.

however, when it comes to debt restructuring/rescheduling. How the key players at the national level are depends on which entity is authorized to contract debt on behalf of the State in domestic law and on the process for contracting debt if national laws stipulates any process at all.

Characteristics of the Guidelines

10. Sovereign lending and borrowing in the context of this document is used in a comprehensive sense. The Guidelines are addressed to both debtors and creditors, public and private. They look beyond a particular legal form and relate to the whole range of debt instruments that countries use to borrow, and covers domestic as well as external debt. The Guidelines use ‘public’ and ‘sovereign’ debt interchangeably.
11. Similarly, within their broad ambit, the Guidelines address the needs of both developed and developing countries as well as professionals entering into a wide range of debt instruments. They seek to identify areas in which there is broad agreement on what generally constitutes sound practice in sovereign lending and borrowing, with a view to safeguarding international financial stability and secure and maintain the gains from development. These Guidelines are mainly intended to assist policymakers by disseminating sound practices adopted by member countries in sovereign lending and borrowing. Their implementation will vary from country to country, depending on each country’s circumstances, such as its state of financial developments, and each country’s needs. The challenge is to develop best practices for adoption by member countries.
12. Some countries are moving towards formally incorporating the Principles into their borrowing and lending Practices. Norway has already used the Principles to carry out an audit of debts owed by developing countries to Norway.⁵ The following section outlines pathways for implementing the Principles.

Pathways to Implementing the Principles

13. The goal of these Guidelines is **to increase the impact of the Principles**. Given their character as general principles, they are formulated at a high level of abstraction. Inherent in such an approach is a high degree of flexibility to tailor the Principles to local needs. It also leaves it up to the stakeholders to adopt different approaches to implementing them in borrowing and lending practices, or indeed to decide not to require their lending and borrowing practices to conform to the Principles.
14. In keeping with the approach of the Principles, these Guidelines provide pathways to implementing the Principles, taking account of the varying circumstances of borrowing

⁵ UNCTAD, Norway to audit debt on basis of UNCTAD principles, <http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=231>.

countries. Their audience is not limited to states, credit officers, sovereign risk managers and other individuals involved in the sovereign debt process. **Civil society too plays an important role** in their implementation. The pathways to implementation outlined below differ with respect to the desirability of formalizing implementation as binding rules as compared to soft law.

15. Elaboration of the Principles, both substantive and technical, is important to maintain their relevance and reach a wider consensus among sovereign borrowers and lenders. An open and public process of elaboration ensures the continued viability of the Principles over time. Key stakeholders in the implementation of the principles are export credit and development agencies and national DMOs.
16. *Reporting on implementation.* There could be periodic reporting on the implementation of the Principles by the Public DMO (or Minister of Finance) to Parliament. The implementation of the Principles could also be delegated to the Public Auditors for reporting to Parliament and to the DMO. Country-specific peculiarities need to be taken into account when implementing the Principles. The administrative law tradition is a particularly important factor.
17. There are **at least three basic modalities** for implementing the Principles. **These pathways for implementation are neither mutually exclusive**, nor exhaustive. There are other ways in which the Principles could acquire importance for sovereign borrowing and lending practices. For example, national courts or international tribunals could incorporate the Principles in their reasoning.⁶ Different principles could be implemented using a combination of the three methods.

1) Incorporation into rules of international law, such as a treaty, customary international law or even general principles of law. Given the current soft law status of the Principles, a binding multilateral treaty is not an option for the foreseeable future.

18. Gelpern has aptly summarized the practical obstacles to a treaty-based solution:

...attempting to negotiate a formal treaty based on the Principles is both infeasible and undesirable at this stage. It is infeasible because treaty negotiation and ratification would take many years—putting off the task of implementation into the far future—and might result in weaker substantive commitments. On the basis of a treaty alone, it will be difficult to reach non-state actors. As a result, a treaty may detract from the horizontal, multi-stakeholder character of the Principles that is their principal strength. No alternative formal commitment vehicle is available to bind diverse public and private actors under international law. Even if it were possible, formalization may be undesirable at this stage. It would risk freezing the current limited

⁶ Dissenting Opinion of Arbitrator Torres Bernárdez in *Ambiente Ufficio S.p.A. and others v. Argentine Republic* ICSID Case No ARB/08/9 (Decision on Jurisdiction and Admissibility), 8 February 2013, para. 330 (referring to the Principles as a reflection of the progressive development of international law on sovereign debt).

*consensus and stymie further development of the Principles to reflect rapid changes in the financial markets and political participation. Paradoxically, early formalization may weaken the compliance pull of the Principles by shifting resources away from generating information and improving organizational practices, to sanctioning bad behaviour in an area where information is scarce, political tensions run high, and consensus on what constitutes compliance is only emerging.*⁷

19. Over the long run, if a wide range of stakeholders adopt the Principles, their formal adoption as a multilateral treaty may be feasible. Which aspects of the Principles may have already hardened into customary international law, or have been incorporated into treaties, or may exist so widely in domestic legal systems that they represent general principles of law is open for debate.⁸ According to the traditional view in international law, the threshold for general principles is high. In order to amount to a general principle, **quasi universal acceptance as a principle or rule is required in the domestic laws** around the world.

2) Incorporation into domestic law. Some of the Principles are commonly found in general domestic civil and criminal law, or in specific legislation such as public debt or public finance laws. Both general codes and specific legislation could be major vehicles for implementing the Principles. General principles of law denote principles widely found in domestic laws that are capable of application in the international legal system.⁹ Existing debt laws often incorporate explicitly some of the Principles (without referring to the Principles). **To a considerable degree, domestic laws already reflect some of the content of the Principles**, or at least leave **room to incorporate them through implementing legislation**. At another, more specific level, they might be incorporated into the regulations governing the conduct of a central player, namely DMOs - potentially one of the most direct and effective channels of modifying the behaviour of debtor countries. **Other key stakeholders are NGOs.** They could, following the example of Transparency International in the field of corruption and transparency, monitor and regularly report on the extent to which states live up to the content of the Principles. Parliaments could monitor the Executive and DMOs.

3) Disclosure and reporting on the Principles conceived as best practices: regular public reports on how States measure up on implementing the Principles - similar to monitoring by the UN Human Rights Treaty Bodies could be another promising avenue for implementation. The success of diverse stakeholders in mobilizing for the implementation of human rights may also hold valuable lessons.¹⁰ The rationale for increased monitoring is that democratic accountability, market discipline and performance of the monitored and monitors are

⁷ Gelpern, *Hard, Soft, and Embedded*, 5-6.

⁸ Michael Waibel, 'Out of Thin Air? Tracing the Origins of the UNCTAD Principles in Customary International Law' in Espósito C, Yuefen L and Bohoslavsky JP (eds), *Sovereign Financing and International Law: The UNCTAD Principles on Responsible Sovereign Lending and Borrowing* (Oxford University Press 2013) (only a few); According to Goldmann, *Comparative Survey* (most aspects of the Principles).

⁹ Article 38 (1) (c); Waibel, *Out of Thin Air*. See also Howse and Bohoslavsky & Espósito.

¹⁰ Beth Simmons, *Mobilizing for Human Rights* (Cambridge University Press, 2008)

enhanced when information is publicly available.¹¹ **A potential difficulty with monitoring**, however, is that the level of abstraction at which they are formulated. Their soft law character compounds these difficulties, and in addition, they are hard to quantify (yet, these Guidelines try to make the Principles more specific). Monitors have considerable leeway in how to interpret the Principles. A first example of this approach is the decision of the International Organization of Supreme Audit Institutions (INTOSAI) to incorporate the principles into its widely accepted international auditing standards.¹²

¹¹ Gelpern, *Hard, Soft, and Embedded*, 6; see also IMF and World Bank, *Guidelines for Public Debt Management* (Washington, 2001).

¹² UNCTAD Principles to be incorporated in auditing standards for sovereign debts - A major step forward 21.06.2013, UNCTAD Press Release.

20. Monitoring could take different forms which are not mutually exclusive:

- i. Public monitoring
- ii. Reporting by civil society groups
- iii. Independent monitors reporting periodically to UNCTAD and/or another organ.

21. The first two forms contribute to public accountability and diffusion of the Principles and promote more disclosure by governments. Independent monitoring promotes better governance for the Principles.¹³

Challenges

22. General principles and customary international law tend to be highly open-textured, lacking in specificity. They **may not always be suited to the technical world of sovereign borrowing and lending**. While some Principles may be sufficiently detailed and normatively backed to provide technical guidance, some Principles reflect current trends in sovereign debt, without the conviction necessary for the formation of customary international law.

23. Although aspects of the Principles are reflected in customary international law or general principles of international law, custom and general principles as such are ~~therefore~~ unlikely themselves to be sufficient for implementing the Principles. Even when stakeholders consider the law as broadly fair ~~exert~~ and the law's thus has compliance pull, implementation requires mobilizing additional resources and relying on other pathways. International law – whether treaty, custom or general principles, may play a limited role to play in the implementation of the Principles. The main routes of implementation spawn the public and private process of sovereign borrowing and lending. In a first stage, its informal use is encouraged for professionals involved in the debt process as it offers an insight on how to strengthen responsibility in sovereign lending and borrowing decisions. Thereafter, states and other actors could formalize responsible policy making. The ultimate aim is a convergence in of regulation on responsible financing in national legislation. ↵

¹³ Gelpern, *Hard, Soft, and Embedded*, 38.

Part II. Understanding the Principles

In this part, the 15 Principles are summarised in their respective sections. A complete explanation of each Principle is offered with the intention to explain how they should be interpreted.

A. Interpreting the Guidelines for Lenders

Principle 1: Agency

The principle and its rationale

24. **Principle 1** holds that every lender, be it in the private or the official sector, should acknowledge that public interest is the main responsibility of government officials that work in sovereign financing. This principle and the corresponding Principle 8 are recognised by the majority of countries. The reasoning is that lenders should only intend to appeal primarily to the public official's duty of pursuing the public interest; otherwise, they would be encouraging the official to breach that duty.¹⁴ Lender liability extends to private lending to sovereign entities. Lenders are liable if they have arranged a debt contract with public officials that they knew ex-ante was not in the borrower's public interest. . In those cases, lenders would not be acting in "good faith" and thus would be liable.

Best practice

25. Lenders should be aware of the borrower's legal framework for public debt management, and the rules and regulations that govern the conduct of public bodies involved in borrowing. Lenders should be aware of and comply with the rules and regulations on integrity.

26. There is virtual unanimity on the principle of criminalising corruption and bribery. Articles 15 and 16 of the UN Convention oblige parties to criminalize the offering of a bribe to a public official (Article 15) or a foreign government official (Article 16), or the solicitation or acceptance of a bribe by that public / foreign official. Article 17 provides that parties shall adopt domestic legislation against 'the embezzlement, misappropriation, or other diversion by a public official for his or her benefit or for the benefit of another person or entity'. Articles 19 and 20 provide that parties will consider adopting legislation criminalizing both the abuse of power of public officials (i.e. not fulfilling the duties of public office in order to gain personal enrichment), and illicit enrichment ('that is, a significant increase in the assets of a public official that he or she cannot reasonably explain in relation to his or her lawful income').

27. Many states have also ratified the respective regional conventions such as the OECD Anti-Bribery Convention and the Inter-American Convention against Corruption. Most

¹⁴ See further OECD, *Managing conflict of interest in the public service* (2003).

countries have relevant provisions in their national law. Moreover, 162 countries are parties to the UN Convention against Corruption. Less widespread is the criminalisation of bribery in relation to foreign officials and officials of international organisations.

28. States agree on the general principle that bribery in relation to foreign officials is not acceptable as a matter of principle.¹⁵ Yet at times bribing foreign officials is not subject to any criminal sanctions, and even if criminalized, sanctions for bribery abroad are often lower, and enforcement much more limited. An important step would be to treat the bribing of all officials in the same way, irrespective of whether a bribe is directed to domestic or foreign officials.

Principle 2: Informed Decisions

The principle and its rationale

29. Lenders should provide information to public borrowers to allow them to make informed decisions. Sovereign borrowers may lack information regarding the lender and it may not be in their best interest to engage in an operation with them. With this principle, lenders are held liable for misleading borrowers by hiding from them key information (akin to the U.S. Federal Law “Truth in Lending Act” which aims at eliminating predatory lending practices).

Best practice

30. In many countries, legislation on consumer lending obliges lenders to provide consumers with sufficient information about the contractual conditions prior to entering into the loan agreement - a best practice for sovereign lending and borrowing. Even though governments are more sophisticated than the average consumer, this Principle recognises that lenders should also put sovereign borrowers in a position to make informed decisions.
31. Argentina, India, Brazil and France, for example, impose specific and demanding requirements on lenders. In India lenders should ensure that the borrower has full knowledge of the implications of the contract.¹⁶ Under the Australian “National Consumer Credit Protection Act 2009”, the lenders must not only provide documents regarding their own credit profile but must take reasonable inquiries to assess the suitability of the borrowers’ financial situation.

Principle 3: Due Authorization

The principle and its rationale

¹⁵ Goldmann, *Comparative Survey*, 17-18.

¹⁶ Goldmann, *Comparative Survey*, 19-20.

32. This principle commands that lenders should make sure that the public counterparty has the proper authorization to enter into a credit agreement and the agreement is enforceable under its jurisdiction. Lenders should be acquainted with the law and ensure that they are dealing with duly authorised entities. Furthermore, understanding the authority to borrow in a per case basis is necessary. The power to raise debt is restricted in most countries to a number of purposes. Lenders will help in this fashion the supervising authority of the borrower to account for the debt contract to prevent any issues arising in the budgetary process. Lending outside the official budgetary process or outside the specified borrowing purposes might force the sovereign to raise taxes or reduce expenditure. Due authorisation should ensure that the borrower is aware of the guarantees by a higher sovereign entity when applicable. In cases of restructuring, the borrower might not be protected by the guarantees if the borrowers has not been duly authorised.

Best Practice

The obligation to meet funding needs

33. Despite the divergent approaches to this issue, countries agree on the general principle that for a contract to be valid, a borrower should have at least prima facie authority, and a lender must have acted in good faith.¹⁷ In the majority of jurisdictions, good faith is not enough, and the lack of authorisation leads to the nullity of the loan agreement. Finally, best practice shows that the legislation giving the right to the agency to borrow should also set out the duty for an institution to be in charge of public debt management.

Principle 4: Responsible Credit Decisions

The principle and its rationale

34. This Principle is linked to the need for Informed Decisions above and describes the need for lenders to assess the capacity of the public agent to service its debt based on the best available information.

35. When the borrower is not the general government, ~~creditors~~ lenders shall verify that:

- A) The borrowing entity has the authority to enter into an external loan contract, and
- B) The borrower has carried out the necessary financial assessment in order to evaluate the economic interest of the purpose of the loan, and
- C) The borrower has proceeded to an assessment of its repayment capacity and the risk that could arise from unexpected events, i.e. the creation of contingent liabilities for the general government budget.

Best Practice

¹⁷ Goldmann, *Comparative Survey*, 23.

36. Contingent liabilities are not debt. They only become debt once one or more conditions are satisfied or events materialise. As a result, the obligation ceases to be “contingent”.¹⁸ The reference to contingent liabilities in Principle 4 should be read as “explicit contingent liabilities”. They arise from contractual arrangements that give rise to conditional requirements to make payments of economic value (e.g. repay a guaranteed debt).
37. Implicit contingent liabilities are only recognised after a condition or event materialises, and they are only assumed if the cost of not assuming them is unacceptably high. Examples of implicit contingent liabilities are default of state-owned enterprises, collapse of the financial system, investment failure of private pension funds, disaster relief, etc.

Principle 5: Project Financing

The principle and its rationale

38. This principle and the corresponding Principle 12 institute obligations of conduct during project financing, rather than free-standing financing for general budgetary purposes. It is the duty of the lender to research ex ante into the project. While it is involved in the project, the lender should do post-disbursement due diligence into the technical aspects of the projects from the financial planning to the environmental implications. Project financing is used to finance infrastructure and industrial projects, often public promoted activities or private with public guarantees.
39. Unlike corporate financing, in which the lender can analyse the borrowing entity's balance sheet, income statement and market record, project financing candidates typically lack those. They are, generally, special purpose entities created solely to implement the project with no significant assets other than those which are part of the project and no historical performance that can be evaluated by the lenders.

Best Practice

40. There should be a national framework to evaluate national projects in order to enable a sovereign borrower to evaluate the internal rate of return of each project and to ensure that the project is in line with national priorities.
41. A positive reference and best practice that could be used in the implementation of this principle is the “Equator Principles”. This private initiative encourages a risk management framework in project finance through which the lender looks into the cash flows of the project by measuring metrics such as the social and environmental risks. The 10 principles it sets out require financial institutions that have adhered to them to monitor

¹⁸ See BIS, Commonwealth Secretariat, Eurostat, IMF, OECD, Paris Club Secretariat, UNCTAD, and the World Bank, *External Debt: Guide for Compilers and Users* (IMF, Washington, 2003), Chapter 9.

independently the standards of the project and, if in breach of any of the standards, to terminate the funding of the project.

Principle 6: International cooperation

The principle and its rationale

42. Lenders should always respect international cooperation agreements by complying with United Nations sanctions. The aim is to enhance cooperation and protect human rights standards as set out in the Universal Declaration of Human Rights.

Best Practice

43. Sanctions imposed by the UN Security Council need to be implemented in domestic law to take effect. As a matter of international law, UN member states are obliged to give effect to sanctions in their domestic law. The guidelines of the UN Global Compact Principle 2 states businesses should not be complicit in human rights abuses. By defining the cases and degrees of complicity, it offers advice to firms on how to create an adequate framework on how to avoid human right abuses. This is akin to Principle 17 of the UN Guiding Principles on Business and Human Rights which underlines the need of businesses carrying out a human rights due diligence to avoid adverse human rights impact. The UN Global Compact Network created groups of business and stakeholders that made the Global Compact principles part of their day-to-day operations. ~~However, implementation has sometimes been patchy.~~

Principle 7: Debt Restructurings

The principle and its rationale

44. In case of a sovereign's inability to meet its debt obligations, the debtor country should seek a speedy and orderly resolution in close co-operation with its creditors. Creditors are obliged to behave "in good faith" generally but this duty is heightened after the borrower is in financial distress.

Best Practice

45. It is the obligation of the lenders to engage in good faith discussions with the borrower, and in the absence of an internationally agreed mechanism for restructuring sovereign debt, creditors should follow the international best practices in close collaboration with the multilateral financial institutions and the Paris Club, in particular collaborating with respect to the implementation of the Paris Club's comparability of treatment. Whereas the Paris Club's comparability of treatment clause only applies in respect of less favourable treatment accorded to financial obligations owed to Paris Club creditors vis-à-vis other creditors, the clause represents an important element of practice that underscores that treating creditors, equally is an important principle.

46. Consensual agreed procedures exist to work-out the debt of countries in financial distress. The IMF plays a central role, especially for low and middle-income countries.¹⁹ In the Eurozone, by contrast, the troika composed of the ECB, the European Commission and the IMF have been the central players. The European Financial Stability Mechanism provides financing to Eurozone countries with acute financing needs to stay current on their financial obligations, subject to strict conditionality.
47. Official and private creditors traditionally expect that an IMF programme with appropriate conditionality is in place. For official lending, the Paris Club is the traditional forum for renegotiating debt. Once an agreement is reached at the Paris Club, the Paris Club Agreed Minute will contain a clause binding the debtor country to seek comparable terms with other bilateral creditors, which do not belong to the Paris Club constituency, and private creditors.
48. Many jurisdictions do not recognise such a principle as a basis for the borrower to request a modification of the payment terms before the formal insolvency proceedings are initiated.²⁰ Under this principle, the creditor would be deemed to be acting abusively if it acquires the sovereign debt instrument with the intention to force preferential settlement outside the consensual workout process. These actions would go against the borrowers' signed clause of *pari passu*. A case widely discussed is Elliott Associates, L.P. against the Republic of Peru.

B. Interpreting the Guidelines for the Responsibility of Sovereign Borrowers

Principle 8: Agency

The principle and its rationale

49. Sovereign borrowing has to comply with the debtor country's law, rules and regulations. All debt contracted should be in line with the objectives and strategy of the borrowing national authority. Furthermore, public officials have an obligation to consider the responsibility that the lenders' agents have towards their institutions.

Best Practice

50. National law determines which national agency enters into debt agreements. For instance in New Zealand the Minister may borrow money on behalf of the Crown, but cannot delegate such power. Under the 1987 Constitution of the Philippines, the bicameral Philippine Congress originates budget related matters²¹, but with respect to sovereign

¹⁹ See Enrique Cosío-Pascal, *The Emerging of a Multilateral Forum for Debt Restructuring: The Paris Club*, UNCTAD Discussion Paper No. 192 (Geneva, 2008); and Enrique Cosío-Pascal, "Paris Club: Intergovernmental Relations in Debt Restructuring," in Barry Herman, José Antonio Ocampo and Shari Spiegel, eds., *Overcoming Developing Country Debt Crisis* (Oxford University Press, New York, 2010).

²⁰ Goldmann, *Comparative Survey*, 52.

²¹ "All appropriation, revenue or tariff bills, bills authorizing increase of the public debt, bills of local application, and private bills, shall originate exclusively in the House of Representatives, but the Senate may

borrowing, Article VII, Section 20 states that authority come solely from the Office of the President. This borrowing framework developed against the background of the Philippine debt moratorium in 1983.

51. Normally, the responsibility of the officials towards their country and its citizens is laid out in the debt law. For instance, in Bolivia and in Portugal, the responsible officials are called upon to monitor law enforcement and compliance in respect of the issuance and management of direct government debt.
52. In South Africa, Chapter 5 of the PFMA provides for the accountability of accounting officers, including the possibility of sanctions. Section 86(3) of this chapter specifies that ‘ Any person, other than a person mentioned in section 66(2) or (3), who purports to borrow money or to issue a guarantee, indemnity or security for or on behalf of a department, public entity or constitutional institution, or who enters into any other contract which purports to bind a department, public entity or constitutional institution to any future financial commitment, is guilty of an offence and liable on conviction to a fine or to imprisonment for a period not exceeding five years.’”

Principle 9: Binding Agreements

The principle and its rationale

53. Principle is linked to Principles 7 and 15 and thus similar comments apply here. A sovereign has a binding obligation to honour its debt contracts. Breaking or modifying the contractual obligations to the lenders may be contemplated in cases of economic necessity and situations in which judicial authorities have ruled that a legal defence is needed.

Best Practice

54. A sovereign has greater justification to seek changes to its borrowing contracts when the economic necessity is derived from events outside the scope of the government’s responsibility or due to unjustified behaviour of the creditors. In 1979, Ghana sought debt restructuring with the support of the *Paris Club*. While the Ghanaian debt crisis was attributed to a sharp fall of the price of cocoa, the generosity of international creditors had limits as they also saw signs of economic mismanagement in Ghana..

Principle 10: Transparency

The principle and its rationale

55. The process for obtaining financing and assuming sovereign debt obligations and liabilities should be transparent. It is the responsibility of governments to put in place and implement a comprehensive legal framework that clearly defines procedures, responsibilities and accountabilities. Arrangements that ensure the proper approval and

propose or concur with amendments.” (Article VI, Section 24, 1987 Constitution of the Republic of the Philippines)

oversight of official borrowings and other forms of financing, including guarantees made by State-related entities, should be put in place.

Best Practice

56. There is a trend towards greater transparency. The role of the Parliament in these procedures should be direct, ranging from approval of every tranche to setting a debt ceiling (footnote 58) or indirect through its power over the budgetary process or taxation (India, the UK). In common law jurisdictions except Nigeria the legislative branch plays a reduced role.

Principle 11: Disclosure and Publication

The principle and its rationale

57. Relevant terms and conditions of a financing agreement should be disclosed by the sovereign borrower in a manner which conforms to standardised reporting requirements. These terms and conditions should be universally available and freely accessible in a timely manner, including through online means, to all stakeholders. If the borrowing is outside the scope of the normal financing activity of the government, reporting on its purposes will increase transparency, even if it is not a reporting standard. Consideration should also be given to long-term reporting on the principal use of the borrowed funds and what actions the government intends to take if tax revenues fall short of projections, and how it seeks to address the shortfall.

Best Practice

58. Governments should respond openly to requests for related information from relevant parties. Legal restrictions to disclosing complete and accurate information should be based on ~~evident~~ public interest considerations and should be used reasonably.

59. Many countries recognise a right of access to information, including to public records. In Brazil, Mexico and India the constitution provides a right to obtain information set on constitutional level. In other countries such a right is enshrined in legislation. Information about the budget is usually widely available on the Internet, including information about outstanding debt, maturities, rates and contractual terms.²² South Africa recognises the right of access to information under the Promotion of Access to Information Act (Act 2 of 2000). All information on national, provincial and municipal budget and debt needs to be available online.

Principle 12: Project Financing

The principle and its rationale

²² Ibid., 21.

60. The sovereign borrower has the responsibility to evaluate ex ante the financial, operational, social, civil and environmental aspects of the projects.

Best Practice

61. Sovereign borrowers should have a control mechanism in place to avoid diverting project loan proceeds to other uses. If the sovereign country has implemented a Treasury single bank account and received income of projects that are financed by the central government, the project loan proceedings should be deposited in the said account. However, the sovereign debtor remains responsible to its lenders for the use of the funds.

Principle 13: Adequate Management and Monitoring

The principle and its rationale

62. A sovereign borrower should implement a legal and institutional framework for public debt management, including direct contingent liabilities. The objective of this framework should be to promote an effective debt sustainability and management strategy. Thus, the framework should aim at dividing the political from the operational functions. **At** the first stage, the political management should be in charge of setting the strategy and the debt management objectives. **During** the next stage, the operations should be managed by agents that are only involved in the implementation of that strategy and should be responsible for achieving those objectives.

Best Practice

63. Since the publication of the IMF and the World Bank “Guidelines for Public Debt Management” and other publications on the subject, virtually all member countries of the IMF have, in some way or another, implemented consistent policies for public debt management, at least for the Central Government budgetary debt.

Principle 14: Avoiding Incidences of Over-Borrowing

The principle and its rationale

64. Public institutions have the responsibility to evaluate ~~projects~~ all borrowing by doing a cost-benefit analysis. The sovereign should only borrow if, marginally, the required social return is more than the interest rate charged on that loan. Sovereigns borrow as an alternative to taxes. Borrowing can help to avoid a sudden reduction of government expenditure by plugging the budget deficit. As borrowing by the central government represents deferred taxes very careful planning of borrowing should be undertaken.

Best Practice

65. Goldman’s comparative survey identified two main models of budget rules preventing sovereign debtors from over-borrowing used by 15 examine jurisdictions: Golden Rule

and numerical debt ceilings, none of which may be considered to fit all cases. Under the Golden Rule debt may only be incurred for investments which generate revenues exceeding the cost of financing. For example, in Nigeria, government may only borrow for capital expenditures and human development at low interest rates and reasonably long amortization periods (footnote 115). In the UK, an informal golden rule requires government to borrow only for investments and not in order to fund structural deficits. Variations of the Golden Rule are also enacted in Mexico and Brazil.

66. Other states use numerical debt ceilings referenced to different macroeconomic indicators (Chile, Spain, and Tanzania) or without reference to any economic indicators (US). Members of the Euro area are subject to the European Stability and Growth Pact and the rules on budgetary discipline stipulated in Article 126 (2) of the Treaty on the Functioning of the European Union.

Principle 15: Restructuring

The principle and its rationale

67. A restructuring of public debt should be undertaken only with the agreement of the sovereign borrower and should be accomplished quickly, efficiently and fairly.

Best Practice

68. The sovereign debtor should react swiftly to such a situation and contact creditors in order to find a quick and orderly solution to its debt service problems. The sovereign debtor should seek that all creditors, including its own nationals, share an equitable burden of the debt adjustment. Very often, as there is no Sovereign Debt Rescheduling Mechanism, creditors request the debtor country to agree to an economic adjustment programme with the IMF that will allow resuming debt service payments as soon as possible. Debtors should, as required from creditors, respect and apply the INSOL Principles.

Part III: The Implementation of the Principles

A. Responsibility of Lenders

Principle 1: Agency

The duty to act in the public interest frequently has a status of constitutional duties (e.g., in Brazil, Chile, China, Germany, Japan, Mexico, Nigeria), or is set out in statutory codifications (e.g., in Argentina, Russia, Tanzania, United States). The content of the duties varies largely depending on the legal system of a country. Generally, the duty is more extensive in civil law countries, and backed by disciplinary and criminal sanctions. Common law countries tend to rely on fiduciary duties. It is not a priori clear that either system is necessarily more effective in ensuring that the agents of the borrowing country act in the public interest. For example, in the UK officials are susceptible to being charged under the common law crime of “misconduct in public office”. However, such misconduct has been narrowly construed by the English courts. Similarly, in the United States, where failure to provide “honest services” may lead to criminal sanctions, the Supreme Court has given a narrow reading to the honest services provision. Even though some countries consider criminal sanctions as inappropriate or only rely on them sparingly, there is broad consensus that public officials need to act in the public interest²³. Yet countries differ on implementation. For example, in the UK all officials – central and local government – are subject to judicial review, which is a review of administrative decision-making²⁴. The judiciary has the ability to ask public officials to reconsider their decisions if they are illegal, unreasonable or unfair.²⁵ In the case of France, the codes of conduct of public servants and specially the *law of 13th July 1983* stipulates that they have a duty to obey and disobey. Public servants should disobey their superiors if they are asked to do something clearly illegal *and* their actions threaten to seriously undermine the public interest. Brazil goes considerably further than most countries, based in part on its recent experience with debt crises in the 1980s: there are financial and criminal penalties, administrative infringements, and political punishments for failing to adhere to the ceilings for net funded/consolidated public debt authorised by the Parliament²⁶.

69. Challenges are to be expected in the implementation of this principle as countries differ in their approach and implementation. The agents not pursuing public interest may find novel practices to avoid persecution and would make it harder for the implementation of the principle to be effective. For example, Germany allows sponsoring of public officials

²³ Goldmann, M., *Responsible Sovereign Lending and Borrowing: The View from Domestic Jurisdictions: A Comparative Survey Written for the UNCTAD* (2012), 16-17.

²⁴ *Council of Civil Service Unions v. Minister for the Civil Service* (1985) AC 374.

²⁵ M. Fordham, *Judicial Review Handbook*, [45.1] and [45.3].

²⁶ Anderson Caputo Silva, Lena Oliveira de Carvalho and Otavio Ladeira de Medeiros, eds., *Public Debt: the Brazilian Experience* (2010), Table 7, p. 213

by businesses but it regulates this activity with a transparent legal framework. Out of the scope of the implementation are private professionals working for public organisations and officials working in the boards of public institutions (OECD guidelines for managing conflict of interest in the public service: report on implantation, 2006)²⁷. A powerful tool against corruption is the United Nations Convention against Corruption in Merida, Mexico in 2003. This instrument can be used for analysis by professionals in a lending process. The Convention requires member countries to implement criminal offences for any corruption-related cases such as bribes and money-laundering. International cooperation was also established on matters of asset recovery and for confiscating property and funds... Thus, criminal charges and international asset recovery should deter wrongdoing.

Principle 2: Informed decisions

70. Normally, a DMO is composed of three separate sections, the front office, the middle office and the back office.²⁸ The front office deals with lenders and creditors. The middle office analyses the effect of new loans on the future debt repayment profile. The back office records debt data, compiles statistics and monitors debt operations and settlements. Countries which have such DMOs include Guyana, South Africa, Norway and Sweden. The Swedish National Debt Office has comprehensive responsibilities and follows a similar structure. The executive management supervises 6 distinct departments; a debt management department that has the front-office responsibilities such as analysis and borrowing, a cash management team that acts to ensure debt repayment, general staff and support departments that are usually classified in the back-office and 2 departments that cover financial stability and guarantees.

71. Lenders should ensure that their proposals have been analysed and evaluated not only by the front office but also by the middle office. Lenders should ensure also that the local authorities have the capacity to run debt sustainability scenarios and that the full effect of the new proposed loans is taken into account in those scenarios. Cooperation among officials from the borrowing and lending sides assures that all related parties are aware of the consequences of the credit decision. The New Zealand Debt Management Office delegates the responsibility of coordination with lenders to the front office.

Principle 3: Due authorization

72. The national authority empowered to contract loans should be spelt out in legislation. For example, in Sweden the debt law provides that “the Government or, after authorisation by the Government, the National Debt Office, may raise loans”. Parliament authorises the Government to borrow for one year for the purposes

²⁷ OECD, Managing conflict of interest in the public service: report on implementation (2006).

²⁸ See Charts 2 and 3 below,

specified in the authorisation.²⁹ In Thailand the exclusive power to raise loans belongs to the Minister of Finance, with the approval of the Council of Ministers. Provision may also be made, in the law, for the delegation of authority to other functionaries. For example in South Africa, section 66 of the PFMA provides that the Minister of Finance may, in writing, permit a provincial public entity to borrow money for bridging purposes up to a prescribed limit. In Tanzania, the Loans, Guarantees and Grants (Amendment) Act 2003 stipulates that the Tanzanian Minister responsible for financial matters has the authorization and guarantee on behalf of the government. However, in many countries the agency/government official concerned has the power to delegate such authority. The requirements for such delegation are typically found in the debt law, or in other statutes.

73. Sometimes the power to raise loans depends on the **type of borrowing**. For example, in Vietnam, ODA borrowing shall be undertaken by the Ministry of Planning and Investment, whereas the Ministry of Finance is responsible for non-ODA borrowing. The Ministry of Finance negotiates specific credit agreements with the authorization of the National Assembly, the Government and the Prime Minister³⁰.
74. The domestic governing law will typically foresee **nullity of a loan agreement if a government borrows without authorisation**. For example, in Brazil, China, Germany, Japan and Nigeria unauthorized loans are considered void even if there might have been apparent authority or a case of estoppel³¹. This approach differs from credit transactions between private parties the validity of which generally does not depend on proper authorisation of agents “as long as the lender is of good faith and has reason to presume that the borrower has been duly authorized” (e.g. in Brazil, China, Germany, Japan, France, UK, USA).³² The difference in treatments of transactions in which a public party is involved seems to result from the assumption that limitations of powers of public agents are generally known. If the lender fails to carry out due diligence, the lack of actual knowledge will be held against the lender...³³ Hence the **importance of lenders to be aware of who is authorised to borrow and to conduct due diligence**. An essential part of due diligence is a legal opinion attesting that the borrowing government is duly authorised.
75. In New Zealand, borrowing is presumed lawful: “Any money that appears to have been borrowed by the Crown under this Act must be taken to have been lawfully borrowed within the powers conferred by this Act, and the person from whom the money was borrowed may not question whether, or to what extent, authority has been given or

²⁹ Section 1, Act on central government borrowing and debt management (1988:1387) of 8 December 1988. See also Ordinance containing instructions for the National Debt Office (2007:1447) of 20 December 2007.

³⁰ Section 7, Public Debt Management Act, B.E. 2548 (2005).

³¹ Goldmann, *Comparative Survey*, 22-23.

³² *Ibid.*, 22.

³³ *Ibid.* Article 7(2)(a) of the Vienna Convention on the Law of the Treaties stipulates that Heads of State, Heads of Government and Ministers for Foreign Affairs may be presumed to have full powers to conclude treaties.

occasion has arisen for the exercise of those powers.”³⁴ In New Zealand the powers of state agents may not be generally known because a Minister who is authorized to borrow under the law may appoint borrowing agents to act on his behalf (powers of which may be unknown to the foreign lender).³⁵

Principle 4: Responsible credit decisions

76. Negotiations between lenders and the front office officials should include an assessment of the capacity of the domestic authorities to deal with the technicalities of the borrowing proposal, a proposal has to be fully evaluated and properly approved by the national authorities, and national authorities need to take the proposal into account in their debt sustainability scenarios. ~~If~~ If private lenders extend financing to countries that are not broadly recognised, to insurgents fighting for independence against their territorial state or to a regime that the international community as a whole regards as illegitimate, there is risk that the lender may not be entitled to be repaid on the basis of the “odious debt doctrine.”³⁶ However, the odious debt doctrine typically only applies in state succession contexts, not when a regime/government changes (e.g. South Sudan).
77. In countries such as Argentina, Germany, France, China, Japan, Mexico, **lenders are obliged to assess the capacity of borrowers to service their loans**. There is a general principle of liability for abusive lending which requires the lender not only to have specific knowledge of the borrower's financial condition, but also fraudulent intent (France, Germany, and the US).³⁷ But as a general principle, it has very limited traction in litigation before domestic courts.
78. When the borrower is not the general government³⁸ creditors shall verify that: The debtor entity has the authority to enter into an external loan contract, and the debtor has carried out the necessary financial assessment to evaluate the purpose of the loan, and the debtor has proceeded to an assessment of its repayment capacity and the risk that could arise from unexpected events.
79. The main source of statistical information for creditors' reference is the IMF's Special Data Dissemination Standard (SDDS). The SDDS' purpose is to guide IMF members that have, or might seek, access to international capital markets in the provision of their economic and financial data to the public. The SDDS, as well as the comprehensive but

³⁴ Section 52(1), Public Finance Amendment Act 2004, No. 113.

³⁵ Section 50(1), Public Finance Amendment Act 2004, No. 113.

³⁶ Hanlon, J., “Illegitimate loans: Lenders, not borrowers, are responsible, (2006), *Third World Quarterly*, 27-2, pp. 211-226

³⁷ *Ibid.*, 30-31.

³⁸ The definitions used here are those of the UN System of National Accounts 2008 (SNA 2008) that are consistent with the Manual of Payments 6 (BPM6), the External Debt Statistics: Guide for Compilers and Users 2003 (Guide 2003) and the Public Sector Debt Statistics: Guide for Compilers and Users 2011 (PSDS 2011). It has to be noted, however, that countries may apply definitions for domestic purposes that differ from those agreed internationally, for instance Brazil: See Silva, Carvalho and de Medeiros, eds., *Public Debt: the Brazilian Experience*, Part I, Chapter 4. Nevertheless, often countries do abide to international standards for reporting to international organizations, keeping internal definitions for domestic use.

less exacting General Data Dissemination System (GDDS) which provides a general system for organising meta data, are designed to enhance the availability of timely and comprehensive statistics and therefore contribute to the pursuit of sound macroeconomic policies. GDDS focuses to a greater extent on socio-demographic data. The SDDS is also expected to contribute to the improved functioning of financial markets. The data on external debt is collected by the World Bank in collaboration with the IMF, and published quarterly.³⁹

80. Once the data has been gathered, a responsible credit decision by the lender involves assessing debt sustainability. A reference point for this matter is the UNCTAD Compendium on Debt Sustainability and Development. The IMF approach to assessing debt sustainability is widely used and easy-to-use. It consists of 4 steps that require forecasting key macroeconomic variables and stress-testing future debt scenarios based on the forecasting assumptions. Other tools used in the private sector are Value-at-risk stress tests which map potential shocks to the debt level based on historical correlations that affect it. Another approach is to evaluate the effectiveness and credibility of debt institutions of borrowing countries. For example, credit rating agency evaluate the institutional strengths of borrowing sovereigns as key factor for their rating.

Principle 5: Project financing

81. Project finance refers to the long-term financing of infrastructure and other major projects in which the cash generated by the project is used to repay the money borrowed to establish the project. Typically, companies or special purpose vehicles are established to carry out the project. Absent guarantees, central and subnational governments are not liable for the debts of these separate entities. As a separate company and the right or concession to operate the project, the project sponsor enters into contractual arrangements with customers and suppliers over an extended period. Therefore, lenders must investigate ex-ante principally the project cash flow to evaluate the capacity of the project to perform its obligations, rather than the creditworthiness central and subnational governments that originally established the project company.

82. When loan proceeds are used to finance projects, lenders should verify that:

- The project is in line with national economic development priorities, including economic, civil, social, cultural and environmental implications.
- The national authorities have carried out a cost-benefit analysis which has shown a reasonable rate of return compared to the rate of interest of the loan financing the project.

83. All 15 jurisdictions examined by Goldman require investigations into environmental implications of projects, whereas only few countries go beyond this requirement.

³⁹ The World Bank, “*Quarterly External Debt Statistics*,” <http://data.worldbank.org/data-catalog/quarterly-external-debt-statistics-ssds>.

Tanzania and Mexico require cost-benefit analyses, Brazil and India mandate social impact assessments.⁴⁰ The recent update of the OECD Guidelines for Multinational Enterprises (2011) requires enterprises, and thus, private lenders, to conduct “risk-based due diligence” when operating abroad.⁴¹

84. Post-disbursement monitoring is a standard feature for Official Development Assistance (ODA). The OECD Development Assistance Committee has adopted principles for evaluation, which guide domestic ODA agencies.⁴² Post-disbursement evaluation at the World Bank comprises interim, terminal and ex-post impact evaluation. Similarly, ODA agencies of France, Germany, Japan, and the US require multiple evaluations at different stages during and after a project.⁴³
85. In South Africa, the Treasury Regulations which implement the PFMA require each accounting officer to prepare a strategic plan that is consistent with the period covered by the Medium Term Expenditure framework. The plan must include, inter alia, details of proposed acquisitions of fixed or movable capital assets, planned capital investments and rehabilitation and maintenance of physical assets; and include details of proposed acquisitions of financial assets or capital transfers and plans for the management of financial assets and liabilities.⁴⁴ This strategic plan must form the basis for the annual reports of accounting officers as required by sections 40(1) (d) and (e) of the PFMA.
86. At the second level, and in those cases where the projects to be undertaken are private-public partnerships, reference must be made to the Public Private Partnership (PPP) Unit in the National Treasury. The South African government approved the PPP unit in April 1997 following the appointment of an inter-departmental task team to develop a package of policy, legislative and institutional reforms to create an enabling environment for PPPs.

Principle 6: International cooperation

87. Lenders should verify that the borrower country is not under sanctions imposed by the UN Security Council. In most countries, sanctions imposed by the UN Security Council need to be implemented in domestic law in order to take effect.⁴⁵ As a matter of international law, UN member states are obliged to give effect to sanctions in their domestic laws. However, implementation has sometimes been patchy. Principle 17 of the UN Guiding Principles on Business and Human Rights notes that business are criminally liable for complicity in a crime such a human rights abuse under most national jurisdictions. A case in point is Iraq's Oil for Food Programme. This was a United Nations program that allowed Iraq to trade oil in exchange for food and other goods satisfying humanitarian needs. The revenues generated by the sale of oil were administered by a

⁴⁰ Goldmann, *Comparative Survey*, 41.

⁴¹ See Part II.A.10 of the OECD Guidelines for Multinational Enterprises.

⁴² OECD, *DAC Principles for Evaluation of Development Assistance*, OCDE/GD(91)208.

⁴³ Goldmann, *Comparative Survey*, 42.

⁴⁴ Treasury Regulations, Chapter 5, sections 5.2.3 (d) – (f).

⁴⁵ Goldmann, *Comparative Survey*, 38-39.

French bank (BNP Paribas) to pay down the war reparations to Kuwait and to be used for the mentioned goods by Iraq.

88. In 2012, several financial institutions agreed to pay billions of dollars to settle accusations that they had breached sanctions against Iran (for example, those agreed in resolution 1696) by laundering money coming from individuals in that country. In this case, revoking their banking licenses and a monetary penalty were used as tools to enforce the sanctions. The lenders were assumed to be aware of the UN sanctions but did not self-regulate correctly. As part of the settlement, the Department of Financial Services of the state of New York accepted a self-monitoring tool that reports directly to the public authorities implemented by the lender as an acceptable policy.

89.

Principle 7: Debt restructuring

90. Several mechanisms have been proposed to improve the status quo treatment of public and private creditors.⁴⁶ If the debtor obtains additional funding during the standstill period or under any restructuring plan, repayment of that debt should be prioritised. All creditors should respect the INSOL Principles.⁴⁷ These include:

- Where a debtor is in financial distress, all creditors should co-operate to gather appropriate information and consider the debtor's restructuring proposals;
- During the standstill period, creditors should refrain from enforcing their claims against the debtor so as not to prejudice the claims of other creditors.
- During the standstill period, the troubled debtor should not take any action which might adversely affect the interests of other creditors. At present, no standstill exists with respect to sovereign debtors. The idea of contractually sanctioned breathing spaces has recently been explored.
- Creditors should co-ordinate their responses by forming committees and appointing professional advisers;
- The distressed debtor should provide all relevant information so that its creditors are able to assess the debtor's capacity to pay, on the one hand and the efficacy of the restructuring proposal, on the other
- All proposals and arrangements of creditors should conform to applicable law and reflect the existing priorities of creditors
- Information concerning the details of the debtor's business should remain confidential

⁴⁶ Udaibir S. Das, Michael G. Papaioannou, and Christoph Trebesch, *Sovereign Debt Restructurings 1950-2012: Literature Survey, Data and Stylized Facts*, IMF Working Paper WP/12/203 (Washington, 2012) provide a recent summary of these proposals.

⁴⁷ International Association of Restructuring, Insolvency & Bankruptcy Professionals, "Statement of Principles," <http://www.insol.org/page/57/statement-of-principles>.

B. Responsibility of Sovereign Borrowers

Principle 8: Agency

91. **The national agency entering into debt agreements should be the one determined by the national law.** For instance, in New Zealand the Minister may borrow money on behalf of the Crown, but cannot delegate such power.⁴⁸ However, he may appoint two or more persons to act on his behalf as joint borrowing agents.⁴⁹ The appointment by the Minister of a borrowing agent does not prevent the exercise by the Minister of a power to borrow.⁵⁰ A borrowing agent may delegate his powers subject to the consent of the Treasury.⁵¹
92. The Constitution and Philippine law⁵² state that before any debt or obligations guaranteed by the government are incurred, they must be approved by the Monetary Board of the central bank, Bangko Sentral ng Pilipinas (BSP): “the President may contract or guarantee foreign loans on behalf of the Republic of the Philippines with the prior concurrence of the Monetary Board, and subject to such limitations as may be provided by law.”⁵³ A Constitutional amendment is required before any agency other than the Office of the President is given powers to incur debt that is guaranteed by the sovereign. For instance, even the central bank would require an amendment to its charter before it is permitted to issue debt, even for its open market operations.
93. Given the Philippine experience with excessive external debt, prospective foreign and foreign-currency denominated borrowings are particularly scrutinized by the BSP. All foreign borrowing proposals of the sovereign, government agencies and financial institutions must be approved by the BSP’s Monetary Board before commencement of actual negotiations, or before a mandate of commitment is issued to foreign funders/arrangers.⁵⁴
94. Normally, the **responsibility of the officials towards their country and its citizens is laid out in the debt law of a country**, for instance in Bolivia⁵⁵ and in Portugal, where one of IGCP’s main duties is “to watch over law enforcement and compliance therewith in everything that concerns the issuance and management of direct government debt”.⁵⁶
95. In South Africa, Section 66 PFMA is explicitly provides that the government needs to borrow, or issue guarantees, indemnities or securities, through the National Revenue

⁴⁸ Section 47(1), Public Finance Amendment Act 2004, No. 113.

⁴⁹ Section 50(1), Public Finance Amendment Act 2004, No. 113.

⁵⁰ Section 51, Public Finance Amendment Act 2004, No. 113.

⁵¹ Section 53(1), Public Finance Amendment Act 2004, No. 113.

⁵² Section 123 (Financial Advice on Official Credit Operations) of Republic Act no 7653.

⁵³ Article VII, Section 20, 1987 Constitution of the Republic of the Philippines

⁵⁴ Guinigundo, Diwa. BIS No. 67. “Fiscal policy, public debt management and government bond markets: the case for the Philippines”. Page 99. <http://www.bis.org/publ/bppdf/bispap67s.pdf>

⁵⁵ Normas Basicas del Sistema de Credito Publico, Resolución Suprema N° 218041, La Paz, 29 de julio de 1997, in Article 36 (Responsibilidades y competencias).

⁵⁶ Article 5 (1) of the By-Laws of the Instituto de Gestão da Tesouraris e do Crédito Público, I.P. (IGCP, I.P.),

Fund. Public entities are similarly restricted in transactions that entail future financial commitments. National government enterprises needed to be listed in Schedule to the PFMA and be expressly authorized by notice in the Official Gazette. Such borrowing may be subject to further restrictions contained in the notice.

96. Apart from these specific borrowing powers, Section 66(4) PFMA prohibits public institutions at the country and provincial level from incurring debt or creating liabilities. It states that such entities, which are not mentioned in the relevant schedule “may not borrow money, nor issue a guarantee, indemnity or security, nor enter into any other transaction that binds or may bind the institution or entity to any future financial commitment; subject only to the provision that the Minister may in writing permit such a provincial public entity or constitutional institution to borrow money for bridging purposes up to a prescribed limit, including a temporary bank overdraft, subject to such conditions as the Minister may impose.” Section 67 prevents sub-sovereign entities from borrowing in foreign currency.
97. The sovereign agency authorised to contract debt should have in place **ethical standards that have to be followed by its employees**. Such standards are usually included in the rules and regulations of DMOs. For example, the “Public Debt and Aid Act” of Guyana, in its Part VI, “Offences”, states that: “An official that falsifies any account, statement, receipt or other record issued or kept for the purposes of this Act, the Regulations, the Finance Circulars or any other instrument made under this Act; conspires or colludes with any other person to defraud the State or make opportunity for any person to defraud the State; knowingly permits any other person to contravene any provision of this Act, is guilty of an indictable offence and liable on conviction to a fine of two million dollars and to imprisonment for three years”.

Principle 9: Binding Agreements

98. Public debt constitutes an **obligation regarding repayment of principal, interest and other borrowing costs**. The obligation to repay is firmly enshrined in the governing law of the debt, whereas the defence of necessity in exceptional circumstances and other defences potentially available to sovereign debtors are considerably less so. Notwithstanding, there is widespread agreement on the principle that in some extreme scenarios, the obligation to repay is modified, suspended or even terminated all together.
99. In the Republic of Serbia **public debt repayment shall have priority over other public expenditures** determined by the budget law. “[A] temporary suspension of budget execution shall not apply to the public debt repayment.”⁵⁷
100. If a country reaches a situation that implies inability to continue its debt obligations as foreseen in the original contracts, the sovereign should:

⁵⁷ Article 13, Public Debt Law of the Republic of Serbia

- Communicate the reasons why debt service has been suspended in a clear and timely manner
- Search for a co-operative negotiation with creditors following the guidelines for Principles 7 and 15, and
- Resume payment of its debts as soon as an agreement has been reached with creditors.
- If lenders sue the debtor state for non-performance of a loan, a debtor may invoke three types of legal defenses⁵⁸:

101. **Defences Originating in the Circumstances of the Conclusion of the Loan.**

Contracts resulting from corruption or in a violation of binding international sanctions (infringing the Principles 1, 6 and 8) are generally null and void.⁵⁹

102. **Financial Necessity as a Defence outside Insolvency Proceedings.** Necessity as a defence is recognised by customary international law and expressed in Article 25 of the Articles on State Responsibility. National laws similarly do not recognise financial necessity as an operational concept that the debtor state could successfully invoke. Economic survival of a state is accepted to be among the factors which might trigger this defence. However, the conditions of such defence are not set uniformly and currently inappropriate for financial necessity as opposed to other types of necessity.

103. As a general principle of law natural disasters are recognised as a defence, though this is very unlikely to extend to debt servicing difficulties. In the civil law countries this idea operates through the concepts of responsibility and *force majeure*⁶⁰, in the common law countries – through the doctrine of frustration.⁶¹ By contrast, economic causes (inflation, market deterioration, etc.) rarely count as a defence. In such cases corporate and individual debtors are usually expected to file for insolvency.

104. **Financial Necessity as a Trigger for Insolvency Proceedings.** Filing for insolvency requires inability of a debtor to pay its debts as they fall due, as opposed to its unwillingness.

Principle 10: Transparency

105. The sovereign borrower should approve and implement a legal and institutional framework for public debt borrowing, which conforms to international best practices. The laws on the DMO's legal status should enshrine rules on transparency for the creditors. However, transparency is also a priority for other agencies and policymakers involved in the process of sovereign borrowing. For instance:

⁵⁸ Goldmann, *Comparative Survey*, 44-50.

⁵⁹ This is the case in all jurisdictions examined by Goldmann, *Comparative Survey*, 44.

⁶⁰ Argentina, France, China, Japan, Mexico (*force majeure*) ; Germany (responsibility).

⁶¹ India, Nigeria, UK.

106. In Portugal, the By-Laws of the Instituto de Gestão da Tesouraria e do Crédito Público spell out the comprehensive legal framework that clearly defines procedures, responsibilities and accountabilities.⁶² In the Dominican Republic, Chapter II of the Ley de Crédito Público sets out the powers of the Consejo de la Deuda Pública.
107. **Ceilings for debt are normally part of the annual budget law that is submitted to Parliament for approval.** The ceilings may be determined on gross debt amounts or in net flows during the fiscal year. The latter are more practical and provide greater flexibility to DMOs. Sometimes the ceiling may be fixed as the GDP/Gross Debt ratio. This is not very practical as the ratio depends very much on the GDP growth rate.
108. The sovereign borrower should implement clear and transparent reporting practices, e.g. reporting by the borrowing entity at least once a year to the Parliament, and an audit mechanism for the DMO to be audited by an independent agency, e.g. the national Supreme Audit Institution, at least once a year. Such procedures are usually governed by DMO law, as for example in Portugal.
109. The publication of a Statistical Bulletin on Public Debt, including stocks, flows and projections, as well as technical analysis (see the next Principle) also contributes to transparency and accountability. Accounting principles are central. Many countries follow cash-accounting that hides real debt owed because it ignores the accrued interest not as yet due. This situation may be misleading for creditors as well as debt managers.
110. In the Philippines, the Central bank is also responsible for ensuring transparency through mandatory quarterly reporting to the Congress: “The Monetary Board shall, within thirty days from the end of every quarter of the calendar year, submit to the Congress a complete report of its decision on applications for loans to be contracted or guaranteed by the Government or government-owned and controlled corporations which would have the effect of increasing the foreign debt, and containing other matters as may be provided by law.”⁶³ A developed civil society has helped to encourage transparency through audit, particularly at the sub-sovereign level. A legal and institutional framework for audits through the citizens' audit processes have been documented by the UNDP.⁶⁴
111. In South Africa, sovereign borrowing is regulated by the Public Finance Management Act (PFMA), 1999 (Act No. 1 of 1999). The PFMA gives effect to section 216(1) of the Constitution of 1996⁶⁵ which requires national legislation to “establish a national treasury and prescribe(s) measures to ensure transparency and expenditure control in each sphere of government ...”. The PFMA in addition gives effect to other sections in Chapter 13 of

⁶² I.P. (IGCP, I.P.), in its Articles 5, Main Duties, and 6, Other Duties, as well as in Chapter III, Management and Auditing,

⁶³ Article VII, Section 20, 1987 Constitution of the Republic of the Philippines

⁶⁴ “Fostering Social Accountability: From Principle to Practice” Guidance Note. United Nations Development Programme (UNDP), August 2010.

⁶⁵ Act No. 108 of 1996

the Constitution, in particular Section 215 which notes that budgets and budgetary processes “must promote transparency, accountability and the effective financial management of the economy, debt and the public sector” ...; Section 218 on the conditions for the issue of guarantees by a government in any sphere

112. The Asset and Liability Management Division within the South African National Treasury is responsible for managing the government’s annual funding programme. The Division provides information to potential creditors, financial markets and the general public relying on its own data, that of the South African Reserve Bank and that of Statistics South Africa. All three data sources subscribe to international reporting standards with the South African Reserve Bank having signed up to the Special Data Dissemination Standard of the International Monetary Fund. For management purposes, the South African government in 2007 adopted the planning tool of a Medium Term Budget Policy Statement (MTBPS).
113. **Across countries, there is a trend towards greater transparency.** The role of the parliament in these procedures could be direct, ranging from approval of every tranche to setting a debt ceiling⁶⁶ or indirect through its power over the budgetary process or taxation (India, the UK). In common law jurisdictions except Nigeria the legislative branch plays a more reduced role.⁶⁷
114. **Some countries use the planning tool of developing medium-term financial frameworks with specific debt targets.** In particular, EU legislation obliges the Member States to set up such frameworks extending over at least three years. In Vietnam, the National Assembly approves the Five-year Socio-economic Development Plan which covers debt targets.⁶⁸ The Prime Minister approves the Medium-term Debt Management Program covering the next three years, which includes balance of domestic and external borrowing requirements, projected annual national external debt to GDP ratios, etc., and the Annual Borrowing and Debt Repayment Plan.⁶⁹ The Ministry of Finance, Ministry of Planning and Investment and the State Bank of Vietnam participate in the preparation of the abovementioned plans.⁷⁰

The planning tool could be used not only to plan level of borrowings, but also to help the DMO to prepare debt service forecasts, as in Guyana, where it is a responsibility of the Back Office.⁷¹ Similarly, the Reserve Bank of Zimbabwe projects the changes in debt service payments that will follow as a result of a concluded contract. While there is a lot of uncertainty in these projections as far as loans are concerned, the forecast accuracy is higher for bond issues.

⁶⁶ In Brazil, the Chamber of Deputies approves of each tranche specifically within debt limit set by the Senate.

⁶⁷ Goldmann, *Comparative Survey*, 24-28.

⁶⁸ Article 7, Law on Public Debt Management No. 29 /2009/QH12.

⁶⁹ Article 9(1), (2), Law on Public Debt Management No. 29 /2009/QH12.

⁷⁰ Articles 10(2), 11(4), 12(4), Law on Public Debt Management No. 29 /2009/QH12.

⁷¹ Article 10(a), Regulations for the Public Debt Management Function Made Under the Public Debt and Aid Act 2006.

115. In New Zealand debt targets are set in a fiscal strategy report presented in each financial year by the Minister to the House of Representatives. The report states long-term objectives (10 or more years) and short-term intentions (2 or more years) for fiscal policy and, in particular, the level of total debt. The fiscal strategy report must assess the consistency of the long-term and short-term objectives with the corresponding objectives of the most recent fiscal strategy report or the budget policy statement. If not consistent, the departure must be justified. The objectives must also be consistent with the principles of responsible fiscal management. Moreover, the short-term intentions must be consistent with long-term objectives. If not consistent with them or with responsible fiscal management, the report must state:

116. Another planning tool used in New Zealand is a statement on the long-term fiscal position which must be prepared by the Treasury and presented to the House of Representatives by the Minister at intervals not exceeding 4 years. The statement must relate to a period of at least 40 consecutive financial years.⁷²

117. In addition, the Treasury must prepare an economic and fiscal update for each financial year, which is presented by the Minister to the House of Representatives immediately after he or she has delivered the Budget for the financial year to which the update relates. The update must contain, among other, a statement of borrowings that reflects the forecast borrowing activities for: the financial year to which the update relates; and each of the next 2 financial years.

118. The Treasury must also prepare a half-year economic and fiscal update, except in cases when a pre-election economic and fiscal update should be prepared.⁷³ Similarly, these updates must contain a statement of borrowings. The updates must be accompanied by a statement of responsibility stating, among other, that the Treasury has, in preparing the update, used its best professional judgments. The statement of responsibility must be signed by the Minister and the Secretary. **Borrowings by sub-state entities are subject to federal approval or debt ceilings** in Argentina, Brazil, India, and Mexico. In some countries such as the United States, a longstanding practice of **no-bailouts** provides incentives for such entities to avoid over-borrowing.⁷⁴

Principle 11: Disclosure and publication

119. Debt data should be published and be accessible to the general public, either as a hard copy and/or an electronic statistical bulletin on the Ministry of Finance or Central Bank Web Site.

120. Publication of public sector data on external debt should follow the international agreed statistical regulations in order to keep confidentiality required by the private sector

⁷² Section 26N, Public Finance Amendment Act 2004, No. 113.

⁷³ Sections 26S, 26T, Public Finance Amendment Act 2004, No. 113.

⁷⁴ Goldmann, *Comparative Survey*, 28-29.

enterprises, e.g. published data should aggregate a minimum of three enterprises, otherwise the specific authorisation for publication should be obtained from the enterprises concerned.

121. A Statistical summary on public debt should be published at least quarterly, ideally monthly. It should set out level and composition of external and domestic debt including maturity, currency and indexed instruments, structure by fixed and floating rate of interest, etc. It should be, preferably, in both nominal and market values, and if not possible, it should clearly indicate if values are nominal or market. Aggregated debt service schedules should also be produced.
122. The publications should follow internationally agreed reporting frameworks in order to make debt data comparable across countries, the UN System of National Accounts 2008; External Debt: Guide for Compilers and Users 2003; The Balance of Payments and International Investment Position Manual, Sixth Edition, 2009; Public Sector Debt Statistics: Guide for Compilers and Users 2011.
123. The Task Force on Financial Statistics wrote two guides on reporting standards for external public debt.⁷⁵ Some countries, such as Brazil, go beyond an annual report on public debt management that analyses public debt management in the previous fiscal year. Based on the previous year annual report, an annual borrowing plan is published after approval by the Parliament which ensures transparency and accountability. Brazil has been publishing this kind of annual report for eleven years already; the last two ones were published earlier in 2012: “Federal Public Debt Annual Report 2011” and “Federal Public Debt Annual Borrowing Plan 2012”.⁷⁶
124. In New Zealand, both the financial planning frameworks, reports, the fiscal strategy report, the statement on long-term fiscal position statements and the economic and fiscal update updates (referred in (i), (j) and (k) of the Guidelines to the Principle 10) must be published. Copies of them must be available for the inspection by members of the public free of charge.⁷⁷ Also, the Minister must arrange for the annual and monthly financial statements and the audit report, and the statement of responsibility to be published.⁷⁸
125. In Thailand, in addition to annual summary report on public debt status, “[i]n each raising of loan, the Ministry of Finance shall publish in the Government Gazette information on the lending institution, currency of loan, aggregate amount of loan, conversion of a foreign currency into Thai Baht, interest rate, fee, expenses, discount,

⁷⁵ BIS, Commonwealth Secretariat, European Central Bank, Eurostat, IMF, Paris Club, OECD, UNCTAD and the World Bank, *External Debt Statistics: Guide for Compilers and Users* (IMF, Washington, 2003); BIS, Commonwealth Secretariat, European Central Bank, Eurostat, IMF, Paris Club, OECD, UNCTAD and the World Bank, *Public Sector Debt Statistics: Guide for Compilers and Users* (IMF, Washington, 2011).

⁷⁶ They are available from http://www.tesouro.fazenda.gov.br/english/public_debt/index.asp.

⁷⁷ Section 26Y, Public Finance Amendment Act 2004, No. 113.

⁷⁸ Section 31(3), 31A(4), Public Finance Amendment Act 2004, No. 113

repayment period of principal, purpose of loan use, condition, measure and other necessary substances...”⁷⁹

126. Countries should provide details of any kind of contingent liabilities originated by sovereign guarantees. This is feasible for direct debt and explicit guarantees, where a binding contract spells out the guarantee. However, for implicit guarantees this might be more complicated. First, because an implicit contingent liability is not debt unless a specific event materialises. Secondly, because there is no legal obligation to assume the liability. It will be assumed only if the “cost of non-assuming is extremely high”. (The cost can be either economic or political)⁸⁰. Therefore, the decision of assuming an implicit contingent liability would always be a very high political decision. It is very unlikely that a country would be in a position—or willing—to report on implicit contingent liabilities because this would be based on hypothetical and uncertain events to materialise.

Principle 12: Project Financing

127. A sovereign borrower should implement a national framework for evaluation of national projects executed by public sector entities and/or by private-public sectors partnerships. This mechanism should permit a sovereign to: (i) evaluate the internal rate of return of the project and compare it with the rate of interest of the corresponding loan; (ii) evaluate if the project is in line with national priorities, including its civil, social, cultural and environmental implications. All the conclusions reached in both evaluations should be accessible to citizens and foreigners.

Principle 13: Adequate Management and Monitoring

128. This framework should include:

- A first delegation for public debt management from the legislative branch (Parliament) to the executive branch (Minister of Finance or the Executive Board on Debt Management)
- A second delegation of the Minister of Finance or the EBDM regarding the operational and technical level to a Public DMO
- An accountability framework for the second delegation where the DMO reports and consults on debt objectives and strategy with the Minister of Finance (or the EBDM) on regular basis
- An accountability framework for the first delegation where the Minister of Finance (or the EBDM) reports to the legislative branch at least once a year
- An independent audit mechanism—i.e. the Supreme Audit Institution (the “SAI”) reporting directly to the legislative branch—for auditing the DMO and the reporting of the Minister of Finance (or the EBDM) to the Parliament

⁷⁹ Section 16, Public Debt Management Act, B.E. 2548 (2005).

⁸⁰ See *External Debt Statistics: Guide for Compilers and Users*, Chapter 9.

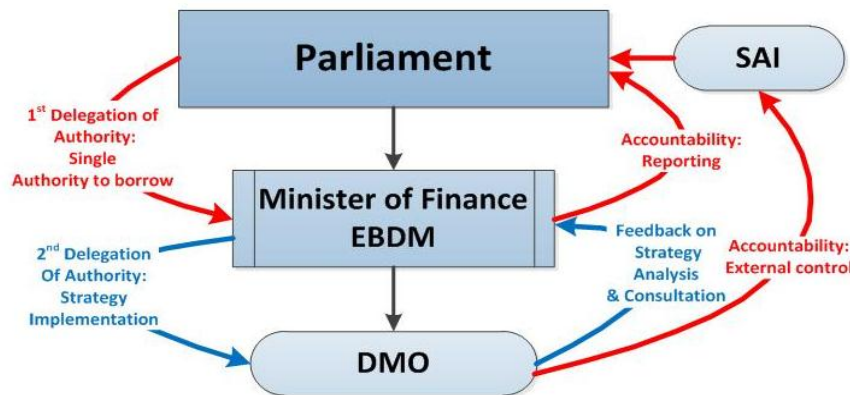
- Audits by the sovereign SAI should also be published, and the audit recommendations not only implemented, but explained publicly how they are implemented.
129. In the case of South Africa, these delegations take the following form:
- A first delegation for public debt management from Parliament (which passed the legislation) to the executive Branch in the persons of the Minister of Finance at national level;
 - A second delegation of the Minister of Finance to the Asset and Liability Division of the National Treasury with respect to the operational and technical level
 - An accountability framework for the first delegation which requires the Minister of Finance regularly to report to Parliament;
 - An accountability framework for the second delegation in terms of which the Asset and Liability Division of the National Treasury reports, through the Director-General to the Minister;
 - An independent audit mechanism, in the form of the Office of the Auditor-General which conducts audits and reports to the legislature. The reports of the Auditor-General are public documents.
130. Since the publication of the IMF and the World Bank “Guidelines for Public Debt Management”⁸¹ and other publications on the subject⁸², virtually all member countries of the IMF have, in some way or another, implemented consistent policies and framework for public debt management, at least for the Central Government budgetary debt.
131. In the Philippines, the BSP, in addition to approving the President’s sovereign borrowing plans, is also charged with monitoring and evaluating the sustainability and macroeconomic impact of sovereign borrowing. For instance, the BSP examines the effects of borrowings on monetary aggregates, FX reserves, the balance of payments and implications for monetary policy. Specifically for external debt, the BSP sets an annual ceiling on foreign loans of the public and private sector in a bid to strike a balance between the country’s external borrowing requirements and macroeconomic stability.
132. In Guyana, the Public Debt and Aid Act 2006 designates a single borrower and guarantee issuer for the Government, the Minister of Finance, and the purposes for which borrowing is authorised. The Act in its article 15 delegates the debt operational and debt management function within the Ministry, including “the management of the public financial debt and assets, contingent liabilities and aggregate cash balances as guided by the current debt strategy of the Government. It will also be responsible for advising on the terms and conditions attaching to proposed grants to the State. The Minister shall issue

⁸¹ See *External Debt Statistics: Guide for Compilers and Users*, Chapter 9.

⁸² IMF and the World Bank, *Guidelines for Public Debt Management: Accompanying Document* (Washington, 2002); IMF and the World Bank, *Amendments to the Guidelines for Public Debt Management* (Washington, 2003); IMF and the World Bank, *Strengthening Debt Management Practices: Lessons from Country Experiences and Issues Going Forward* (Washington, 2007).

Regulations pursuant to this Act specifying the responsibilities relating to the various objectives of the debt management function”. Part II of the Regulations for the Public Debt Management Function Made Under the Public Debt and Aid Act 2006 define the structure and organisation of the debt management function given to it the form of three offices: the back office (Part III), the middle office (Part IV) and the front office (Part V). Chart 1 illustrates a transparent legal framework for borrowing:

Chart 1
Legal framework for borrowing



Transparent legal frameworks for borrowing have the following characteristics:

Set of single authority to borrow:

- Parliament is the ultimate power to authorize public borrowing of the central government. However, Parliament is not involved in individual debt management issues (unless exceptional commitments)

133. The Parliament delegates the public debt management operations to the executive branch, usually the Minister of Finance or a board of high rank officers chaired by the Minister of Finance—in most of the cases including the Governor of the Central Bank—, through a national debt law or as a section in the public finance law.

134. The Minister of Finance delegates exclusive powers for public debt management and borrowing responsibilities to a single and one debt management entity (the Public DMO (DMO)); this delegation is formalised through a decree or a secondary legislation, e.g. rules and regulations. DMO could form a part of the ministry of finance (Argentina, Egypt) or be a private limited company that is wholly owned by the government

(Germany). Given that the government is the majority shareholder, the German DMO is to be considered a public entity. ⁸³

135. The powers cover both foreign and domestic markets and involve management of public liabilities and other debt-related transactions, e.g. issuing and contracting debt, entering in derivatives operations (swaps) and issuing loan guarantees.
136. In Sweden the Parliament authorises the Government which, in its turn, authorises the National Debt Office to raise and manage loans.⁸⁴ The latter authorisation is formalised by the ordinance issued by the Ministry of Finance. The National Debt Office is empowered to provide, raise and manage loans, provide and manage central government guarantees.⁸⁵
137. The organisational structure and functions of the structural units of the DMO is often established by the DMO itself. Establishment of structure should be subject to approval by the Government (specifically Minister of Finance, as in Portugal).⁸⁶
138. The DMO is led by a board. The Government should have powers to appoint all or at least key positions within the board. For example, in Sweden the Government appoints the vice-chairperson of the board of the Debt Office.⁸⁷ Similarly, a director of Public Debt Agency of the Republic of Serbia is appointed by the Government, at the proposal of the Minister of Finance.⁸⁸ In Portugal “[t]he chairman and other members of the board of directors are appointed by Cabinet Resolution, on a proposal from the Finance Minister, for renewable three-year terms of office.”⁸⁹

⁸³ Goldmann, *Comparative Survey*, 40.

⁸⁴ Section 1, Act on central government borrowing and debt management (1988:1387) of 8 December 1988.

⁸⁵ Section 2, Ordinance containing instructions for the National Debt Office (2007:1447) of 20 December 2007.

⁸⁶ Article 11, Decree Law No. 160/96 of 4 September, by-Laws of the Instituto de Gestão da Tesouraria e do Crédito Público, I.P. (IGCP, I.P.).

⁸⁷ Section 22.1, Ordinance containing instructions for the National Debt Office (2007:1447) of 20 December 2007.

⁸⁸ Article 43, Public Debt Law of the Republic of Serbia.

⁸⁹ Article 5.1, Decree Law No. 160/96 of 4 September, by-Laws of the Instituto de Gestão da Tesouraria e do Crédito Público, I.P. (IGCP, I.P.).

Effective debt management functions:

139. UNCTAD's Effective Debt Management Functions⁹⁰ provides a useful benchmark for the assessment of the domestic legal and institutional framework. These functions are summarized in Chart 2:

Chart 2
Effective Debt Management Functions and Outputs

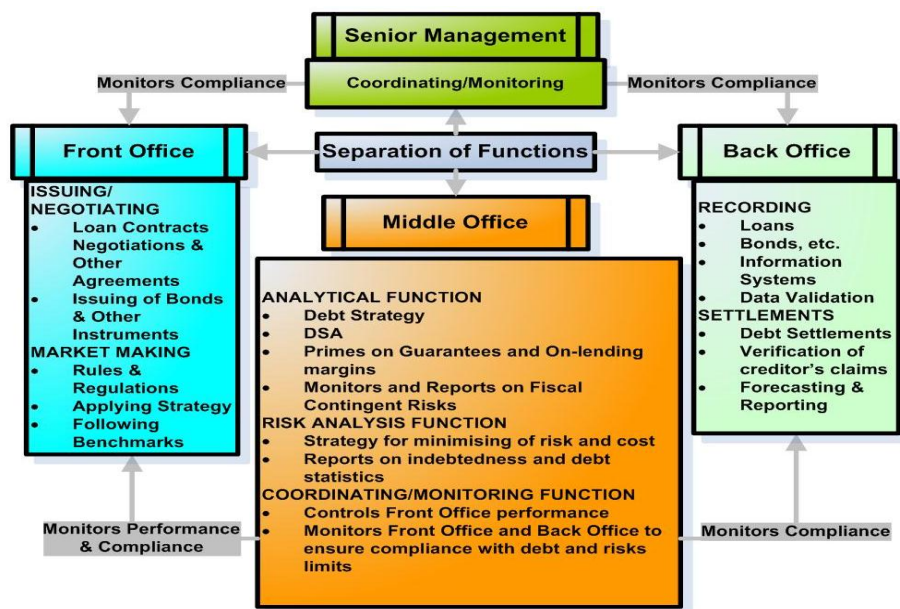
<u>Executive Debt Management</u>	⇒	<u>Direction and Organization</u>
Policy function	⇒	Strategy
Regulatory function	⇒	Structure
Resourcing function	⇒	Staffing and systems
<u>Operational Debt Management</u>	⇒	<u>Debt Dynamics and Practice</u>
Controlling/coordinating/ monitoring	⇒	Control, coordinate, and monitor
<u>BACK OFFICE</u>		
Recording function	⇒	Debt data and statistics
Operating/monitoring functions	⇒	Debt operations settlement and monitoring
<u>MIDDLE OFFICE</u>		
Analytical function	⇒	Analysis and financial strategy
Risk analysis function	⇒	Minimize cost and risk
<u>FRONT OFFICE</u>		
Issuing/negotiating function	⇒	Securities, loans, and restructuring agreements
Market-making	⇒	Government securities trading

140. A paramount function is Risk Analysis. The first risk management measure which a DMO should adopt is the segregation of duties among the three offices, where the senior management and middle office have the paramount role of monitoring compliance. This is represented in the Chart 3 below. Legal documentation, especially for external borrowing, is very relevant for the purposes of risk management. Due to the potential higher risks associated with foreign currency debt, the middle and senior office need to evaluate if this borrowing option is the most cost efficient and whether the legal structure of the contracts and the delivery of the documentation are done in a timely fashion. A major advantage of an effective debt management framework is enhanced coordination. Information would flow faster once the structure of the borrowing process is clearly defined, especially if operational functions are delegated to a central body like a DMO. Coordination would also help borrowing agents have a more comprehensive view of the debt portfolio and thus help in assessing portfolio risks.

⁹⁰ See DMFAS/UNCTAD, *Effective Debt Management*, UNCTAD/RDP/DFP/DMS/2(1989); DMFAS/UNCTAD, *Effective Debt Management*, UNCTAD/GID/DMS/15 (1993); Enrique Cosío-Pascal, *The DMO and the Effective Debt Management Functions: An Institutional and Operational Framework*, LAC Debt Group, Inter-American Development Bank (Washington, 2007).

141. The back-office ensures that the operational risk management serves effectively to monitor and record of transactions. It should also supervise the settlement of transactions which should follow a strict and secure authorisation process. More efficient operational controls will reduce the risks of fraudulent activities happening such as embezzlement and policy breaches. An accurate and consistent recording of transaction will lead to a comprehensive database and management system that can improve the effectiveness of senior officials in their decision-making and monitoring activities. The middle office in charge of financial strategy should analyse and supervise the cash balance management. Forecasting the financial needs (e.g. when a loan comes due) should ensure with a high degree of certainty that the cash balance covers the payment of debt obligations. The middle office will determine if cash flow forecasting which evaluates future government revenue and expenditure is accurate enough to avoid failure in meeting financial obligations.
142. In Guyana, the regulations on public debt⁹¹ define the structure and organisation of the debt management function given to it in the form of three offices: the back office (Part III), the middle office (Part IV) and the front office (Part V). The back office has functions of debt servicing, IT and database development and maintenance, and record keeping and reporting. The Middle Office performs functions of debt and aid strategy, policy formulation, relationship management and controlling and monitoring the debt and aid management performance. Finally, the Front Office is responsible for resource mobilisation (e.g. loan negotiations) and management of the Government debt portfolio.

Chart 3
DMO's Internal Controls: Segregation of the Debt Management Functions



⁹¹ Regulations for the Public Debt Management Function Made Under the Public Debt and Aid Act 2006.

143. In jurisdictions where Islamic “sukuk” securities exist, an additional review function is necessary to ensure that all government debt issued are in compliance with Shariah principles. An example is in Malaysia, where its Shariah Advisory Council comprising Shariah scholars, jurists and market practitioners is the supreme authority in Islamic finance and provides guidance on Islamic capital market activities, including government sukuk issuance.⁹²

144. In South Africa, the Asset and Liability Division of the National Treasury has the following elements:

- sections 38(1)(a)(i) and 51(1)(a)(i) of the PFMA, which require the Accounting Officers/Authorities to ensure that their institutions have and maintain effective, efficient and transparent systems of risk management;
- section 6(2)(a) of the PFMA, which empowers the National Treasury to prescribe uniform norms and standards in terms of the Act; and
- section 20(1) (iv), (v) and (vi) of the MFMA which empowers the Minister of Finance to prescribe uniform standards in terms of that Act.

For this reason, the duties among the various offices are separate in order to ensure that there is effective management and oversight is maintained on all operations. The separation of duties also contributes to business continuity planning as the different departments of the debt authority can prepare for any incidents.

Specific borrowing purposes

145. The delegation of the borrowing power—in order to limit mismanagement—is normally restricted by a statement of purposes for which the executive can borrow and by the limit of an annual net borrowing and/or the level of total public debt outstanding. While the Parliament has a power to establish debt ceilings annually, the Government could have a power to determine supplementary conditions governing the negotiation, contracting and issue of loans by the DMO, as in Portugal.⁹³ The purpose of borrowing is often determined by the debt law, as in Sweden, where the debt law provides that loans could be raised in order to finance current budget deficits, provide credits and fulfil the guarantees decided on by the Parliament, amortise, redeem and purchase central government loans or meet the Riksbank’s (the Central Bank’s) need for currency reserves.⁹⁴ Similarly, the Public Debt Law of the Republic of Serbia specifies that “[t]he Republic may borrow to finance budget deficit and liquidity deficit, to refinance the outstanding debt, to finance investment projects and to make payments on guaranties.”⁹⁵

⁹² Central Bank of Malaysia Act 2009 (<http://www.bnm.gov.my/index.php?ch=7&pg=715&ac=802>)

⁹³ Articles 4 and 5, Law on General System Governing the Issue and Management of Public debt No. 7/98 of 3 February.

⁹⁴ Section 1, Act on central government borrowing and debt management (1988:1387) of 8 December 1988.

⁹⁵ Article 5, Public Debt Law of the Republic of Serbia.

In Thailand⁹⁶ and the Socialist Republic of Vietnam⁹⁷ the borrowing purposes are also specified in the debt law. In contrast, in New Zealand the Minister “may borrow money on any terms and conditions that the Minister thinks fit”⁹⁸ “if it appears to [him] to be necessary or expedient in the public interest to do so”.⁹⁹

146. In South Africa, Section 71 PFMA sets out the following specific borrowing purposes:

1. to finance national budget deficits;
2. to refinance maturing debt or a loan paid before the redemption date;
3. to obtain foreign currency;
4. to maintain credit balances on a bank account of the National Revenue Fund;
5. to regulate internal monetary conditions should the necessity arise; or
6. any other purpose approved by the National Assembly by special resolution.

Clear debt management objectives and strategy

147. The debt management objectives are set in view of accountability of the public debt management and borrowing authority (DMO). The objectives ensure that there is a formal target against which the DMO’s performance can be evaluated. Strategy is formulated in order to attain the objectives, i.e. the practical implementation of the stated objectives. The strategy/guidelines for debt management could be decided on by the Government after obtaining a proposal from the DMO and an opinion on the proposal from the Parliament, as in Sweden.¹⁰⁰ Similarly, in Portugal the guidelines for public debt management are proposed by the Public Debt Management Institute.¹⁰¹ In the Republic of Serbia the Ministry prepares public debt management strategy which shall be submitted to the Government for approval once a year.¹⁰² In Thailand Public Debt Policy and Supervision Committee proposes public debt management plan for each fiscal year for approval of the Council of Ministers.¹⁰³

Mandatory annual reporting to the Parliament

148. Mandatory annual reporting is a self-evaluation of the performance of the DMO undertaking its responsibilities under the borrowing delegation by the Parliament. This reporting focus on the evaluation of outcomes against the stated objectives and the implemented strategy by the DMO.

⁹⁶ Section 20, Public Debt Management Act, B.E. 2548 (2005).

⁹⁷ Article 18, Law on Public Debt Management No. 29 /2009/QH12.

⁹⁸ Section 54, Public Finance Amendment Act 2004, No. 113.

⁹⁹ Section 47, Public Finance Amendment Act 2004, No. 113.

¹⁰⁰ Section 6, Act on central government borrowing and debt management (1988:1387) of 8 December 1988; Section 3.1, Ordinance containing instructions for the National Debt Office (2007:1447) of 20 December 2007.

¹⁰¹ Decree Law No. 160/96 of 4 September, by-Laws of the Instituto de Gestão da Tesouraris e do Crédito Público, I.P. (IGCP, I.P.).

¹⁰² Article 11, Public Debt Law of the Republic of Serbia.

¹⁰³ Section 35, Public Debt Management Act, B.E. 2548 (2005).

149. For instance, in Sweden the Government evaluates the management of central government debt in writing to the Parliament.¹⁰⁴ The National Debt Office submits information for the evaluation of the management of central government debt to the Government annually.¹⁰⁵ In Portugal the Government, through the Minister of Finance, reports to the Parliament quarterly on the financing obtained and the specific conditions of the loan agreements concluded.¹⁰⁶ In South Africa, the executive authority responsible for a department or public entity is required to table in the National Assembly or a provincial legislature an annual report, financial statements, the Auditor-General's report on those statements and, if applicable, the findings of a disciplinary board, and any sanctions imposed by such a board.
150. There is no mandatory reporting on public debt management by the DMO provided in the debt law in Portugal: the Parliament may summon the Chairman of the DMO for a hearing.¹⁰⁷ Such reporting should be mandatory. In the Socialist Republic of Vietnam the Government on submission of the Ministry of Finance should provide public debt reports to the National Assembly and its Committees (annually or on request), including information on progress of the implementation of the Government's annual borrowing and debt repayment plan and progress of the implementation of the programs and projects using the Government's debt finance.¹⁰⁸
151. In New Zealand, "[t]he Treasury must, as soon as practicable after the end of each financial year, prepare annual consolidated financial statements for the Government reporting entity for that financial Year" which compares the actual financial statements with the forecast financial statements. The statements must include "a statement of borrowings that reflects the borrowing activities for that year, including budgeted figures for that year and comparative actual figures for the previous financial year."¹⁰⁹ The Minister must present the annual financial statements and the audit report to the House of Representatives, together with the statement of responsibility, and arrange for them to be published.¹¹⁰ The Treasury must also prepare monthly financial statements which include "a statement of borrowings that reflects the borrowing activities for the period of the financial year to the end of the month concerned."¹¹¹

Audit of public debt management and public borrowing:

¹⁰⁴ Sections 7, Act on central government borrowing and debt management (1988:1387) of 8 December 1988.

¹⁰⁵ Section 3.2, Ordinance containing instructions for the National Debt Office (2007:1447) of 20 December 2007.

¹⁰⁶ Article 14.1, Law on General System Governing the Issue and Management of Public debt No. 7/98 of 3 February.

¹⁰⁷ Article 14.2, Law on General System Governing the Issue and Management of Public debt No. 7/98 of 3 February.

¹⁰⁸ Article 44(1), Law on Public Debt Management No. 29 /2009/QH12.

¹⁰⁹ Section 27, Public Finance Amendment Act 2004, No. 113.

¹¹⁰ Section 31, Public Finance Amendment Act 2004, No. 113.

¹¹¹ Section 31A, Public Finance Amendment Act 2004, No. 113.

152. The Parliament will have the powers to request an audit of the DMO performance and activities undertaken by an independent body. This body is, in most of the cases, the Supreme Audit Institution (SAI) that is independent of the executive branch¹¹² and reports directly to the Parliament (legislative branch)¹¹³ or to the executive¹¹⁴. In South Africa, the task of auditing government accounts in general and debt in particular is the responsibility of the Auditor-General.¹¹⁵ In an ideal scenario, the external audit should be made public and cover every aspect of the debt management process. The audit report should offer an insight into the policies, operations and the management and monitoring activities. The audit referred in this section should ideally be consistent with the recommendations of the International Organization of Supreme Audit Institutions (INTOSAI) and its Working Group on Public Debt¹¹⁶.
153. An example of the involvement of the Superior Audit Institution regarding public debt is to be found in the “Public Finance Amendment Act 2004, N° 113” of New Zealand. This Act says in its New Section 29A, “Power of Secretary to obtain information”, in paragraph 30-(1) For example, in New Zealand “[t]he Treasury must forward the annual financial statements to the Auditor-General not later than the end of the second month following the end of the financial year to which those statements relate”; 30-(2) “The Auditor-General must: (a) audit the annual financial statements of the Government; and (b) provide and audit report to the Treasury within 30 days after receiving them”.
154. Another example is “The Law on Public Debt Management” 29/2009/QH12, of Vietnam, which in its Article 5, paragraph 5, states: “Transparency and information disclosure shall be applied in all the stages of debt raising, debt finance allocation and use, debt repayment and other public debt management processes. Projects and programs that are financed by the borrowings of central Government and/or sub-national governments must be audited by the State Auditor or other independent auditors”.
155. There could also be a permanent audit committee within the structure of the DMO (internal audit). For instance, in Portugal the audit committee is comprised of one chairman and two members appointed by the Minister of Finance for a renewable three-year period.¹¹⁷ The audit committee is responsible for monitoring and controlling the financial management of the DMO, checking the appropriate bookkeeping and compliance with budgetary and accounting provisions, etc. Such internal audit committee contributes to the sound public debt management by the DMO.

¹¹² E.g. Brazil, France, Germany, Japan, Mexico, Nigeria, United States, UK according to Goldmann, *Comparative Survey*, 40.

¹¹³ E.g. the US according to Goldmann, *Comparative Survey*, 40.

¹¹⁴ E.g. Egypt, Nigeria according to Goldmann, *Comparative Survey*, 40.

¹¹⁵ Act No.25, 2004.

¹¹⁶ UNCTAD, 15th July 2013, *UNCTAD Principles to be incorporated in auditing standards for sovereign debts - A major step forward*.

¹¹⁷ Article 19, Decree Law No. 160/96 of 4 September, by-Laws of the Instituto de Gestão da Tesouraria e do Crédito Público, I.P. (IGCP, I.P.).

Principle 14: Avoiding Incidences of Over-Borrowing

156. Budget deficits may be high at times of temporary economic distress and low—preferably zero or in surplus—in times of prosperity. The classic situation is wartime or natural disasters that require exceptional spending that is financed mostly by borrowing, rather than current taxation. The policy of paying for added public spending with debt issue works only if the extra spending is temporary. If the expansion of the public sector is permanent, then deficit finance implies that taxes must be raised even more in the future, partly to pay for the added government expenditure and partly to finance the extra debt. Thus, the proper response to a permanent expansion of the public sector is a corresponding rise in tax revenues, not more public borrowing.
157. Sovereigns would like to issue securities whose payoffs are contingent on required coupon or interest rates for future debt issues. The goal is to insulate the public budget from variations in these rates. This objective can be accomplished by issuing indexed government bonds linked, for example, to the consumer price index, and then choosing an appropriate maturity structure for the debt, which imply the design and implementation of adequate medium- and long-term debt strategies. There has also been a proposal to link sovereign’s debt payoffs to the GDP rate of growth.
158. Goldman's Comparative Survey identified two main models of budget rules preventing sovereign debtors from over-borrowing used by 15 examined jurisdictions: Golden Rule and numerical debt ceilings, none of which may be considered to fit all cases¹¹⁸ Under the Golden Rule, debt may only be incurred for investments which generate revenues exceeding the cost of financing. For example, in Nigeria, government may only borrow for capital expenditures and human development at low interest rates and reasonably long amortization periods¹¹⁹ In the UK, an informal golden rule requires government to borrow only for investments and not in order to fund structural deficits. Variations of Golden Rule are also enacted in Mexico¹²⁰ and Brazil.¹²¹
159. Other states use numerical debt ceilings referenced to different macroeconomic indicators (Chile, Spain, and Tanzania) or without reference to any economic indicators (the US).¹²² For example, in Germany the cyclically-adjusted annual net budget deficit may not exceed 0.35percent of nominal GDP. Brazil, Nigeria and the UK implemented numerical debt ceilings in addition to their golden rules.¹²³ Another example is Serbia where limitation on borrowing for budget deficit financing “shall be for the net amount of debt that can be outstanding at the end of a budget year.” This net amount is determined by the budget law.¹²⁴ Liquidity borrowing (the purpose of financing imbalances of

¹¹⁸ Goldman, *Comparative Survey*, 31-37.

¹¹⁹ Section 41, Fiscal Responsibility Act (No. 31, 2007).

¹²⁰ Art. 73(viii), Mexican Constitution. Additional exceptions apply for monetary policy and conversion operations.

¹²¹ Art. 167(iii), Constitution of Brazil.

¹²² Goldman, *Comparative Survey*, 33-35.

¹²³ *Ibid.*, 35.

¹²⁴ Article 7, Public Debt Law of the Republic of Serbia.

revenues and expenses of the budget during a budget year) must not exceed 5 percent of the total realized revenues in the previous budget year.¹²⁵ In Turkey, “net debt utilization can be made up to the difference between the allocations mentioned in the budget law and estimated revenues”. There could be increases up to 5percent a year and additional 5percent on decision of the Council of Ministers upon the proposal of the Minister and the Undersecretary of the Treasury.¹²⁶

160. Members of the Euro area are also subject to the European Stability and Growth Pact and the rules on budgetary discipline stipulated in Article 126(2) of the Treaty on the Functioning of the European Union. Those rules cap budgetary deficits at 3percent of GDP and aggregate debt at 60 per cent of GDP. Economic deteriorations might justify larger debt ratios. Furthermore, on 2 March 2012 the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union was signed by 25 Member States.¹²⁷ According to the Article 3 of the Treaty a structural deficit should not exceed 0.5percent of nominal GDP or 1percent if country’s debt-to-GDP ratio is significantly below 1 per cent.

161. Restrictions limiting the debt often apply to federal and municipal entities, e.g. in Argentina, Brazil, Germany, India, Mexico. In the United States such limits are not established by federal law, rather by states themselves.¹²⁸

162. The legislature plays an important role, as through the budget law it approves for each fiscal year - debt ceilings, either on net flow or nominal basis. For instance, in Portugal the Parliament, by means of a law, establishes for each budgetary period the ceiling on the increase in authorised net indebtedness and the longest maturity of the loans to be floated. The law may establish the maximum amount to which certain types of public debt (debt denominated in foreign currency, fixed-rate debt and variable-rate debt) may be subject.¹²⁹

163. If the budget fails to being implemented at the beginning of the fiscal year (due to nonvoting, disapproval, non-publication, etc.) a Government may authorise the issue of public debt in certain amount. For example, in Portugal such amount cannot exceed “an amount equivalent to total repayments falling due in the meantime plus 25 per cent of the maximum amount of the increase in net indebtedness authorised in the preceding budgetary period.”¹³⁰

¹²⁵ Article 6, Public Debt Law of the Republic of Serbia.

¹²⁶ Article 5, Law on Regulating Public Finance and Debt Management No. 4749 of 28 March 2002.

¹²⁷ The Treaty will enter into force on 1 January 2013, provided that twelve Eurozone members ratify it, or on the first day of the month following the ratification by the twelve Eurozone members, whichever is the earliest.

¹²⁸ Goldmann, *Comparative Survey*, 36-37.

¹²⁹ Article 4, Law on General System Governing the Issue and Management of Public debt No. 7/98 of 3 February.

¹³⁰ Article 7.1, Law on General System Governing the Issue and Management of Public debt No. 7/98 of 3 February.

164. Debt managers, as well as fiscal policy makers, should be very cautious, as the budget gap represents a net transfer, not a gross flow, which implies that in order to borrow to cover the gap the corresponding debt service (amortisation of principal and interest payments) should be added to the gap (the snow ball effect of indebtedness) in order to calculate the required gross borrowing to close the gap.
165. In order to deal with the point above, regular debt sustainability exercises should be undertaken, on the one hand, and medium-and long term-public debt strategies should be implemented and evaluated on regular basis, on the other hand. In Malaysia, for instance, long-term government debt strategy is incorporated into an overarching national capital market development strategy such as that articulated in its 2001 Capital Market Master Plan intended to serve as a roadmap for the country's capital markets development over the next decade.¹³¹
166. The DMO should implement a risk management policy. For instance, in Sweden the National Debt Office produces internal instructions for managing the risks, continuously reviews and monitors compliance with them¹³². Decisions on the framework and guidelines for handling the risks are taken by the board of the National Debt Office¹³³. To start with, the segregations of functions in the three offices structure is required (see Chart 3 above).

Principle 15: Restructuring

167. The decision to restructure should be taken only after careful evaluation of all alternatives and only after a conclusion that restructuring is the best available alternative for the debtor country, its population and the creditors as a group or the only viable solution.
- the sovereign debtor should react swiftly to such a situation and contact creditors in order to find a quick and orderly solution to its debt service problems.
 - the sovereign debtor country should not discriminate among creditors and respect the process as well as seniority of debts. In this respect, certain principles of domestic insolvency law are widely accepted and could be applied with modifications to borrowing countries, namely:
 - the equality of creditors with respect to payment conditions (*par conditio creditorum*)
 - the right to pro rata payments of creditors in the same priority class (*pari passu*)
 - the priority of secured creditors or creditors enjoying privileges which are in the public interest, and
 - the decision-making by majority.¹³⁴

¹³¹ <http://www.sc.com.my/ENG/html/cmp/CONTENTS.PDF>

¹³² Section 4, Ordinance containing instructions for the National Debt Office (2007:1447) of 20 December 2007.

¹³³ Section 15.5, Ordinance containing instructions for the National Debt Office (2007:1447) of 20 December 2007.

¹³⁴ Goldman, *Comparative Survey*, 50-51.

- the sovereign debtor should seek that all creditors, including its own nationals, share an equitable burden of the debt adjustment.
168. Very often, as there is no Sovereign Debt Rescheduling Mechanism, creditors would request the debtor country to agree to an economic adjustment programme with the IMF that will allow resuming debt service payments as soon as possible. The debtor country should try to obtain this agreement with the IMF as quickly as possible.
169. Sovereign debtors should include collective Action Clauses (CACs) in all long-term debt instruments. CACs are contractual provisions that grant a qualified majority of holders of debt securities the ability to change the terms of the issuance and bind the rest of the holders to the new terms (including agreeing to restructuring that would require the forgiveness of principal or interest, or implementing maturity or interest rate changes).
170. CACs come into play when an issuer needs to restructure its debt and the holders are faced with the alternative either to consent to the restructuring or to enforce the debt obligations. They are designed to help address the problems that arise when a minority within the bondholders of a security seeks to take advantage of a majority of holders that are willing to reach a restructuring arrangement with the debtor in difficulties: the majority might be hesitant to agree to restructure if they fear that the minority will threaten to hamper the workout unless they are paid in full.
171. There is no consensus about the CACs among the authors. For instance, Becker et al.¹³⁵ find that primary and secondary market yields do not show evidence that the presence of CACs increases yields for either higher or lower-rated issuers. Therefore, by implication, the perceived benefits from easier restructuring are at least as large as any costs from increases in moral hazard. In contrast, Das et al. opine that the actual use of CACs in past debt restructurings shows mixed results.¹³⁶
172. Debt instruments issued under English law and bonds issued under New York law often include CACs. Also, Argentina, Chile, Egypt, Mexico, and Nigeria include CACs. From 2013 CACs will be included in all Euro zone government bonds.¹³⁷
173. However, CACs have some shortcomings. First, the aggregation clause seems more promising for restructuring a small group of similar classes of bonds rather than for more complicated capital structure. Second, although CACs counteract the collective action and holdout problems, they leave several other sovereign debt issues untouched, where one of the most important shortcomings of the sovereign debt markets is the absence of an enforceable priority structure. This last point might have as consequence that creditors'

¹³⁵ Torbjörn Becker, Anthony Richards and Yunyong Thaicharoen, *Bond Restructuring and Moral Hazard: are Collective Action Clauses Costly?* IMF Working Paper WP/01/92 (August 2001).

¹³⁶ Das, Papaioannou, and Trebesch, *Sovereign Debt Restructurings 1950-2012*, 44.

¹³⁷ Goldmann, *Comparative Survey*, 53.

inability to create enforceable priorities may lead to risk of debt dilution. And last, but not least, a CACs-based approach does not address concerns such as the need for a standstill while the sovereign debtor is renegotiating its obligations.¹³⁸

Summary and Conclusion

174. These guidelines establish a methodology to understand and implement the Principles on Promoting Responsible Sovereign Lending and Borrowing, published by UNCTAD. The first part describes the rationale behind the Principles and pathways to implementation. They describe the process of putting into use the Principles from the initial steps to the monitoring and the potential challenges. Three main methods were discussed: (1) Incorporation of principles-based rules into international law as they become the norm, (2) incorporation into domestic law and (3) public monitoring of the use of best practices associated with the principles.
175. Part II focused on how the Principles can be applied in practice, with reference to examples of best practice. Furthermore, the best practices that are the foundations of this methodology are elaborated throughout the text. The understanding of the principles helps users implement them.
176. Finally, the implementation is described in part III as an on-going process rather than a definitive stage. The implementation process is described for each principle with an overview of the current policies and tools used in different jurisdictions.

¹³⁸ See Patrick Bolton and David A. Skeel, Jr, (2010), “How to Rethink Sovereign Bankruptcy”, in Herman, Barry; Ocampo, José Antonio, and Spiegel, Shari, *Overcoming Developing Country Debt Crisis*, Oxford University Press, New York.

Glossary

Abusive lending refers to practices by lenders that can be deemed to be fundamentally unfair to the borrowers. Abusive lending often involves misrepresentations, misleading product information or opaque fee structures.

Bailout is the intervention and explicit financial support of an entity due to its inability to continue operations that can take the form of stocks, bonds, loans or cash (which may or may not require reimbursement). If the intervention is carried out by the government or related body, there is normally an existing legal structure that guarantees implicitly or explicitly the entity's survival.

By-law is a rule established by an institution to regulate itself as recognized **Capital assets** are assets that are owned and generate cash flows over a longer period of time.

Debt ceiling is an institutional or legislative limit on the amount of debt that can be borrowed or paid for.

Debt management office is the agency responsible for carrying out sovereign debt management by minimizing financing costs over the long term.

Fiduciary duty is an ethical or legal relationship of confidence between two or more parties
Contingent liabilities are liabilities that may become current liabilities depending on the outcome of a future event

Due diligence is an operational control, which may be a legal obligation, to research a person or a company prior to signing a contract.

Debt restructuring is a process used in institutions that are in financial distress to avoid bankruptcy and increase liquidity by renegotiating their debt obligations.

Financial distress occurs when the borrowing entity is close to being unable to remain current on its financial obligations.

Hard law refers to binding legal instruments and laws

Internal rate of return is the rate of return necessary to make an investment profitable.

Odious debt is money borrowed by a country and misused by the national rulers. The amount borrowed weighs upon the country's population as it did not derive benefits from the lending but is responsible for the repayment of the debt. **Official Development Assistance (ODA)** is a measurement metric of aid employed by the Organization for Economic Co-operation and Development (OECD)

Primary and secondary markets. Bonds and other fixed income securities are issued for the first time in the primary market. The secondary market is where investors can buy and sell bonds that have been issued but have not matured.

Priority structure refers to the order of claims over assets of a company's capital obligation in the case of bankruptcy. Senior debt holders are the first to recover the value of their outstanding credit in the form of assets and the last are the equity holders.

Public (sovereign) debt is the sum of the financial obligations of all government bodies.

Soft law refers to legal or quasi-legal instruments that are not legally binding or that are subordinated to other instruments.

Sovereign debt restructuring mechanism is a framework proposed by the IMF for permitting countries facing financial crises to restructure their debts in an orderly manner and efficient manner.

Structural deficit occurs when a country runs a deficit despite its economy running at full potential.

Swap is a financial instrument in which the counterparties of the agreement have the obligation to exchange cash flows depending on a predefined benchmark. In the case of an interest rate swap, a party will provide a variable interest rate payment while the other a fixed rate payment.

United Nations Human Rights Treaty Bodies are committees of international and impartial experts in charge of monitoring the implementation of human rights treaties.

Bibliography

Abedian, I., 2004. Balancing the Nation's Books. In: Parsons, R., (ed.) *Manuel, Markets and Money*, Juta Books. Ch.3.

Act on central government borrowing and debt management 1988:1387 (Kingdom of Sweden).

Becker, T., Richards, A. and Thaicharoen, Y., 2001, *Bond Restructuring and Moral Hazard: are Collective Action Clauses Costly?* IMF Working Paper WP/01/92 (August 2001).

Bolton, P. and Skeel, Jr, D.A., How to Rethink Sovereign Bankruptcy. In Herman, B., Ocampo, J. A. and Spiegel, S., *Overcoming Developing Country Debt Crises*, New York: Oxford University Press, 2010).

Borensztein, E. and Mauro, P. *Reviving the Case for GDP-Indexed Bonds*, IMF Policy Discussion Paper PDP/02/10, (IMF, Washington, 2002).

Borrowing Powers of Provincial Governments Act 1996 (Republic of South Africa).

Silva, A. C., Carvalho, L. O. and. Medeiros, O. L., 2010, *Public Debt: the Brazilian Experience* eds., Table 7, p. 213.

By-Laws of the Instituto de Gestão da Tesouraria e do Crédito Público, I.P. (IGCP, I.P.), Article 5:1(Portugal)

Central Bank of Malaysia Act 2009. Available at:
<<http://www.bnm.gov.my/index.php?ch=7&pg=715&ac=802>>

Constitution of the Republic of the Philippines, 1987.

Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996)

Cosío-Pascal, Enrique 2007, *The DMO and the Effective Debt Management Functions: An Institutional and Operational Framework*, LAC Debt Group, Washington: Inter-American Development Bank

Cosío-Pascal, Enrique, 2008, *The Emerging of a Multilateral Forum for Debt Restructuring: The Paris Club*, Geneva: UNCTAD Discussion Paper No. 192

Cosío-Pascal, Enrique, 2010, Paris Club: Intergovernmental Relations in Debt Restructuring.. In Herman, B., Ocampo, J. A. and Spiegel, S., *Overcoming Developing Country Debt Crises*, New York: Oxford University Press (2010)

Griffith-Jones, Stephany and Sharma, Krishnan, 2006, *GDP-Indexed Bonds: Making it Happen*, New York: DESA Working Paper No. 21 ST/ESA/2006/DWP/21.

Council of Civil Service Unions v. Minister for the Civil Service 1985:AC 374(United Kingdom).

Das, Udaibir S., Papaioannou, Maria G. and Trebesch, Cristoph, 2012, *Sovereign Debt Restructurings 1950-2012: Literature Survey, Data and Stylized Facts*, Washington: IMF Working Paper WP/12/203

DMFAS/UNCTAD, *Effective Debt Management*, UNCTAD/RDP/DFP/DMS/2(1989)

DMFAS/UNCTAD, *Effective Debt Management*, UNCTAD/GID/DMS/15 (1993)

Fordham, Michael, *Judicial Review Handbook*

Anna Gelpern, 'Hard, Soft and Embedded: Implementing Principles on Promoting Responsible Sovereign Lending and Borrowing' in Espósito C, Yuefen L and Bohoslavsky JP (eds), *Sovereign Financing and International Law: The UNCTAD Principles on Responsible Sovereign Lending and Borrowing* (Oxford University Press 2013)

Matthias Goldmann, M., *Responsible Sovereign Lending and Borrowing: The View from Domestic Jurisdictions: A Comparative Survey Written for the UNCTAD* (2012)

Guinigundo, Diwa *Fiscal policy, public debt management and government bond markets: the case for the Philippines*, BIS No. 67, available at: <<http://www.bis.org/publ/bppdf/bispap67s.pdf>>

Barry Herman, 2010, Why the Code of Conduct for Resolving Sovereign Debt Crises Falls Short, in Barry Herman., José Antonio Ocampo and Shari Spiegel (ed.), *Overcoming Developing Country Debt Crises* (New York: Oxford University Press, 2010)

IMF and World Bank, *Guidelines for Public Debt Management* (Washington: International Monetary Fund, 2001)

IMF and the World Bank, *Strengthening Debt Management Practices: Lessons from Country Experiences and Issues Going Forward* (Washington: International Monetary Fund, 2007)

International Association of Restructuring, Insolvency & Bankruptcy Professionals, "Statement of Principles,". Available at: <<http://www.insol.org/page/57/statement-of-principles>>.

Law on General System Governing the Issue and Management of Public debt No. 7/98 of 3 February (Portugal).

Law on Public Debt Management No. 29 /2009/QH12 (Socialist Republic of Vietnam)

Municipal Finance Management 2003, Act No. 56 (Republic of South Africa).

National debt office, 2007: 1447, Ordinance containing instructions for the National Debt Office (Republic of Sweden)

National Treasury, 3 September 2001, “South Africa Makes Final Debt repayment in Debt Standstill Net” (Republic of South Africa) Available at: <www.info.gov.za/speeches>

National Treasury of the Republic of South Africa, 1997, Three Year Budget Policy Statement, Pretoria: National Treasury.

National Treasury of the Republic of South Africa, 2001, *Treasury Regulations*, Ch. 5 (Republic of South Africa).

Ministerio de Economía y Finanzas Públicas del Estado Plurinacional de Bolivia, Normas Básicas del Sistema de Crédito Público, 1997, Resolución Suprema N° 218041 (Estado Plurinacional de Bolivia)

New Central Bank Act of the Philippines 2003 (act no 76523), Financial Advice on Official Credit Operations

OECD, *DAC Principles for Evaluation of Development Assistance* OCDE/GD(91) 208

OECD, *Guidelines for Multinational Enterprises* (2011)

OECD, *Managing conflict of interest in the public service: report on implementation* (2009)

Public Debt Law of the Republic of Serbia

Public Debt Management Act 2005, B.E. 2548 (Kingdom of Thailand).

Public Finance Amendment Act 2004, No. 113 (New Zealand).

Public Finance Management Act 1999 (Republic of South Africa).

Ruban, Oleg, Poon, Ser-Huang and Vonatsos, Konstantinos, *GDP Linked Bonds: Contract Design and Pricing* (University of Manchester, 2009)

Beth A. Simmons, *Mobilizing for human rights : international law in domestic politics* (Cambridge University Press 2009)

United Nations, 2003, *External Debt Statistics: Guide for Compilers and Users*

United Nations, Manual of Payments 6 (BPM6)

United Nations, 2011, *Public Sector Debt Statistics: Guide for Compilers and Users*

United Nations, 2010, External debt sustainability and development, New York: United Nations, UN Doc. A/65/155

UNCTAD, 2009, *Compendium On Debt Sustainability and Development*.

UNCTAD, Norway to audit debt on basis of UNCTAD principles. Available at: <<http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=231>>.

UNCTAD, 15th July 2013, *UNCTAD Principles to be incorporated in auditing standards for sovereign debts - A major step forward*. Available at:< <http://www.unctad.info/en/Debt-Portal/News-Archive/Our-News/International-auditing-standards-to-streamline-UNCTAD-Principles-on-sovereign-financing-21072013>>

UNCTAD, 1986, *Trade and Development Report*, New York: UNCTAD.

United Nations Development Programme, “Fostering Social Accountability: From Principle to Practice” Guidance Note. August 2010.

Michael Waibel, ‘Out of Thin Air? Tracing the Origins of the UNCTAD Principles in Customary International Law’ in Espósito C, Yuefen L and Bohoslavsky JP (eds), *Sovereign Financing and International Law: The UNCTAD Principles on Responsible Sovereign Lending and Borrowing* (Oxford University Press 2013)

World Bank, Guide to the Debt Management Performance Assessment (DEMPA) Tool, Revised December 2009

World Bank, *Quarterly External Debt Statistics*

World Bank Operational Directive, *Project Monitoring and Evaluation*, OD 10.70 (1989)