



HM TREASURY

Ensuring effective debt relief for poor countries: a consultation on legislation

July 2009



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Foreword

The UK Government remains determined to lead global efforts to tackle poverty in the world's poorest countries. In an increasingly interdependent world, international development is vital to our interests as well as quite simply being the morally right thing to do.

Delivering and exceeding our international commitments – reached through our work with the G8, G20 and Paris Club – is a priority for the Government. It is increasingly clear that direct aid must be supplemented by measures that help poor countries to tackle their situations themselves. We are helping to free up resources for vital development projects and public services by relieving the burden of debts accumulated in previous decades by some of the very poorest states. The rationale for this, as highlighted by the excellent work of many civil society organisations, is simple. A country that is forced to spend more servicing historical debt than it is able to spend on education and health services combined faces a self reinforcing cycle of poverty. It is right that we lead the world in breaking that cycle.

Some creditors of poor countries are choosing not to participate in the Heavily Indebted Poor Countries Initiative for debt relief. While that is their prerogative, it can lead to a 'free rider' problem: debt relief from others gives the debtor countries resources that can be siphoned off by non-participating creditors pursuing full payment of their debt.

These claims, including those brought in UK courts, mean that poor countries are forced to pay back some of their outstanding debt in full and with the addition of interest. The nature of these cases means that a small minority of creditors can divert some of the benefits of debt relief provided by the majority. The Government is determined that these actions do not prevent poor countries from using the resources freed up by debt relief for development and poverty reduction. And we firmly believe it is right to act to prevent this from happening at the expense of debt relief funded by the UK taxpayer.

I welcome all contributions to this consultation, and recognise the work done by the Jubilee Debt Campaign and others in raising awareness of these globally important issues.



Ian Pearson MP
Economic Secretary to the Treasury

1

Introduction

Subject of the consultation

1.1 The UK Government has taken the lead in driving forward international efforts to relieve the debts of heavily indebted low-income countries. Since 1999, the international community has put in place two major debt relief initiatives to ensure that none of the poorest countries in the world faces a debt burden they cannot manage. Under the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative, all creditors are encouraged to provide a common level of debt reduction to the 40 eligible countries. Most major creditors, including the UK, have committed to do so. The Multilateral Debt Relief Initiative (MDRI), launched in 2005, provides 100 per cent relief on debts owed to the major international financial institutions by countries completing the HIPC Initiative. In total, the UK has already delivered \$3.1bn of debt relief to HIPCs since 1996, and has committed substantially more.

1.2 However, the voluntary nature of international debt relief creates opportunities for individual creditors to refuse to participate and then attempt to recover – through legal action – the full value of their debt, using the greater capacity for payment created by debt relief. While this is the creditor's legal right, it has a particularly negative effect for the poorest and most indebted countries: it diminishes the impact of debt relief granted by other creditors by reducing the resources available to the country to finance development. In the worst abuses of the debt relief process, investors have bought the debts of HIPCs at the low prices prevailing before debt is cancelled, with the sole intention of litigating for full repayment and extracting a profit at the expense of the country and of other creditors that provide relief: a model that has been termed a 'vulture fund.' The UK and other countries have condemned this practice and taken action to limit the harm it can cause. However, while these steps have reduced the extent of the problem, there remains scope for some creditors to undermine international debt relief efforts.

1.3 This consultation sets out a proposal that would limit the proportion of debts already contracted by a HIPC that a creditor could reclaim under UK laws. It aims to gather views on the approach put forward.

1.4 Some forms of legislation in this area could have the potential to deter new commercial investment in developing countries or damage the UK's position as a financial centre through excessive impact on the position of investors. It is the Government's clear purpose to avoid these negative consequences and the measure put forward for consultation is designed to be tightly targeted to avoid any impact on new lending and control the impact on existing creditors.

1.5 Responses are welcomed by 9 October 2009.

Box 1.A: Questions in this consultation

Purpose and scope

Question 1: Do you agree that there is a need for further action to tackle non-co-operative creditor litigation against Heavily Indebted Poor Countries?

Question 2: Do you agree that any legislation should be targeted at the public debts of Heavily Indebted Poor Countries?

Question 3: Do you agree that any legislation should only apply to debts contracted before the legislation takes effect?

Question 4: Do you agree with the costs and benefits of legislating set out in the Impact Assessment?

Question 5: Do you think that there is the possibility for further voluntary initiatives from commercial creditors of Heavily Indebted Poor Countries? If so, how effective would these be in increasing commercial co-operation in the HIPC Initiative?

Question 6: Are there other non-legislative measures that can be taken to address the problem?

Design of legislation

Question 7: What do you consider should be used as the reference point in specifying the maximum value that can be reclaimed from a debt covered by the legislation?

Question 8: Do you think that original creditors should be specifically excluded from the scope of new legislation?

Question 9: Do you agree that legislation should include a provision to value debts above the terms specified, if it is found to be just and equitable to do so?

Question 10: What factors, if any, should be specified to consider in the use of discretion to value debts above the terms specified?

Question 11: Do you think that any alternative or complementary legislative approaches would better accomplish the Government's purpose?

Operation and enforcement

Question 12: Do you agree that legislation should apply to those debts on which judgment has already been obtained?

Question 13: Do you agree with the Government's proposals relating to international aspects of legislation?

Structure of the consultation

1.6 The rest of the consultation is divided into five sections:

- Chapter 2 – sets out the background to the consultation, explaining the purpose and operation of debt relief and the problem posed by creditors that litigate for higher settlements;
- Chapter 3 – considers whether there is a need for legislation and defines what debts it should apply to;
- Chapter 4 – discusses the more detailed elements of the design of legislation;
- Chapter 5 – outlines how new legislation would be applied to existing debts and those with an international element; and
- Annex A – presents an impact assessment for the policy proposed in this consultation.

Responding to the consultation

1.7 Comments on the specific questions raised in the consultation are welcome. Where possible, stakeholders are encouraged to provide evidence to support specific points. This consultation began with the publication of this document and will last for a period of 12 weeks, closing on 9 October 2009. Responses should be sent by email if possible to:

debtrelief.consultation@hm-treasury.x.gsi.gov.uk

Or by post to:

Debt relief consultation
c/o Dominic Curran
International Development and Climate Change
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

1.8 Please note our preference is to receive responses in electronic format only (all email responses will be acknowledged).

1.9 This document can be found on the website of HM Treasury (www.hm-treasury.gov.uk). When responding, please state whether you are responding as an individual or as part of an organisation. If responding on behalf of a larger organisation, please make it clear who the organisation represents and, where applicable, how the members' views were assembled.

Consultation disclosure

1.10 All written responses may be made public on the Treasury's website unless the author specifically requests otherwise in writing.

1.11 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regime. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act (DPA) and the Environmental Information Regulations 2004.

1.12 If you would like the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of information we will take full account of your explanation, but we cannot give an assurance that confidentiality will be maintained in all circumstances.

1.13 In the case of electronic responses, general confidentiality disclaimers that often appear at the bottom of emails will be disregarded for the purpose of publishing responses unless an explicit request for confidentiality is made in the body of the response. Subject to the previous two paragraphs, if you wish part (but not all) of your response to remain confidential, please supply two versions – one for publication on the website with the confidential information deleted, and another confidential version for use by the Treasury.

Any Freedom of Information Act queries should be sent by email to:

public.enquiries@hm-treasury.gov.uk.

Or by post to:

Correspondence and Enquiry Unit

Freedom of Information Section

HM Treasury

1 Horse Guards Road

London

SW1A 2HQ

Code of practice for written consultation

1.14 This consultation is being conducted in line with the Code of Practice for written consultation (a full version can be found at www.cabinetoffice.gov.uk/regulation/code.htm), which sets down the following criteria:

- consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy;
- be clear about what the proposals are, who may be affected, what questions are being asked, and the timescale for responses;
- ensure the consultation is clear, concise and widely accessible;
- give feedback regarding the responses received and how the consultation process influenced the policy;

- monitor the department's effectiveness at consultation, including through the use of a designated consultation coordinator; and
- ensure your consultation follows better regulation best practice, including carrying out an Impact Assessment if appropriate.

1.15 If you feel that this consultation does not fulfil these criteria, please contact:

Angela.Carden@hm-treasury.gov.uk. Or by post:

Angela Carden
Better Regulation Unit
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Impact assessment

1.16 An impact assessment for the options under consideration is published with this document at Annex A and should be read in conjunction with this consultation. The impact assessment considers qualitative, and where possible quantitative, benefits and costs for implementation.

2

Background

Development and poverty reduction

2.1 The Government believes it is in the interests of the UK and the world to tackle the many challenges of world poverty. In an increasingly interdependent world, international development is vital to global common interests that will profoundly affect the quality of life for all: building international prosperity and security, and addressing the global threat of climate change. The Government's strategy was most recently set out in the White Paper on International Development, *Building our Common Future*¹. This is focused on progress towards the Millennium Development Goals², which set out a global commitment to halve poverty by 2015. Through the Department for International Development (DFID), the Government has transformed the scale and impact of its development work. But many challenges remain to further progress.

Debt relief

2.2 Debt relief contributes to poverty reduction and development for low income countries by reducing the unmanageable burden of debt that many had built up in the decades to the 1990s. The level of debt service payments amongst this group had risen to levels that exceeded their combined spending on health and education, while new investment was deterred by the overhang of old commitments. Debt relief frees up resources for these priorities – for example, countries that have benefited from relief have raised average spending on health and education from 7 per cent to 9 per cent of Gross Domestic Product and now spend on average six times more on them than they do on debt service³. There is also some evidence that countries that have received relief benefit on average from an improved macroeconomic position, with higher economic growth and lower inflation⁴.

2.3 The two international agreements on debt relief are the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative, established in 1999, and the Multilateral Debt Relief Initiative (MDRI), agreed at Gleneagles in 2005. The UK has taken a leading role in driving forward debt relief internationally. The Government – supported by a wide range of civil society groups – has worked with other countries to implement and extend far-reaching debt relief, and gone beyond its international commitments to further assist the poorest countries.

¹ <http://www.dfid.gov.uk/Documents/whitepaper/building-our-common-future.pdf>

² <http://www.un.org/millenniumgoals/>

³ IMF, HIPC and MDRI Status of Implementation 2008, <http://www.imf.org/external/pp/longres.aspx?id=4278>

⁴ IMF Working Paper, External Debt Sustainability in HIPC Completion Point Countries: An Update <http://www.imf.org/external/pubs/ft/wp/2009/wp09128.pdf>

Box 2.A: The HIPC and MDRI initiatives

The HIPC Initiative was launched in 1996 to ensure that no poor country faces a debt burden it cannot manage. A comprehensive review in 1999 resulted in the Enhanced HIPC Initiative, providing faster, deeper and broader relief, and placed poverty reduction at the heart of debt relief. Eligibility for the HIPC Initiative is ring-fenced to those countries that before 2004 had a low average income and debt levels that were unsustainable even after earlier levels of relief. These 40 countries are listed in Table 2A. Under the Initiative, once a country demonstrates a commitment to poverty reduction and a good track record of economic management, all its creditors are expected to provide relief on its debts at a level calculated to reduce these debts to sustainable levels.

In 2005, the HIPC Initiative was supplemented by the Multilateral Debt Relief Initiative (MDRI). This provides 100% cancellation of the debts of countries completing the HIPC Initiative to four principal multilateral bodies: the IMF, World Bank, African Development Bank and Inter-American Development Bank.

2.4 There are two stages to gaining HIPC Initiative relief – Decision Point and Completion Point. To reach Decision Point, a country must achieve macroeconomic stability and develop a plan for poverty reduction. At this stage, the international community commits to reducing the country's debt to a sustainable level, with the 19 major bilateral government creditors (grouped together in the Paris Club⁵) immediately providing relief on its debt service payments. The World Bank and International Monetary Fund (IMF) also calculate the Common Reduction Factor – the proportion of the country's debts which all creditors will need to cancel in order to bring the debt down to a sustainable level.

2.5 At Decision Point, the IMF and World Bank agree with the country the "triggers" that the country must meet to complete the initiative. These set out reforms to the country's approach to poverty reduction and financial and economic management that ensure the benefits of debt relief can be directed towards reducing poverty and building economic growth. When the triggers are achieved and Completion Point is reached, the Paris Club countries cancel their debt in proportion to the Common Reduction Factor. The initiative is voluntary and there have so far been different levels of participation from creditors. The Paris Club and principal multilateral institutions participate fully; not all other sovereign creditors and commercial creditors have provided the same degree of relief. The UK and other Paris Club countries urge all creditors to participate fully⁶.

2.6 The UK and many other major creditor countries go beyond HIPC Initiative requirements and cancel 100% of debts owed to them by HIPCs at this point.

2.7 Since 1999, 26 of the 40 countries have completed the HIPC Initiative, while a further 9 have reached Decision Point and qualified for interim debt relief. Over \$110bn of debt relief has been delivered or committed worldwide under the initiatives.

⁵ The website at <http://www.clubdeparis.org/en/> lists members, standard terms, and details of individual agreements

⁶ A condition of all Paris Club debt treatments, including those provided within the context of the HIPC Initiative, is that debtor countries seek comparable treatment from all their other creditors.

Table 2A. Country status on the HIPC Initiative, July 2009⁷

Post-Completion Point	Interim (post-Decision Point)	Pre-Decision Point
Benin	Afghanistan	Comoros
Bolivia	Chad	Eritrea
Burkina Faso	Congo , Democratic Republic	Kyrgyz Republic
Burundi	Congo, Republic of	Somalia
Cameroon	Côte d'Ivoire	Sudan
Central African Republic	Guinea	
Ethiopia	Guinea-Bissau	
The Gambia	Liberia	
Ghana	Togo	
Guyana		
Haiti		
Honduras		
Madagascar		
Malawi		
Mali		
Mauritania		
Mozambique		
Nicaragua		
Niger		
Rwanda		
São Tomé and Príncipe		
Senegal		
Sierra Leone		
Tanzania		
Uganda		
Zambia		

Non-participation

2.8 One of the major challenges of the HIPC Initiative is to ensure that eligible countries receive the level of debt relief needed from all their creditors. \$4.3bn of the debt relief due under the HIPC Initiative (6 per cent of the total) is expected from commercial creditors but, so far, the World Bank and IMF estimate that only around a third of this has been provided⁸.

⁷ A list of the countries and their current status in the Initiative can be found at <http://go.worldbank.org/4IMVXTQ090>

⁸ Status of Implementation Report on the HIPC and MDRI Initiatives, September 2008; Spring 2009 HIPC At A Glance http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1240603491481/Debt_PocketBroch_Spring09.pdf

2.9 Debt relief under the HIPC Initiative is voluntary. Even once a country reaches Completion Point, creditors retain their legal rights to enforce claims against the country concerned. However, before entering HIPC, the market value of all creditors' debts is often much below the nominal value of the debt: the debtor country is expected to be unable to meet all of its repayment commitments and the expected return on holding that debt is therefore correspondingly low⁹. For companies in this position, insolvency law generally provides for all creditors to realise a loss and to be repaid an equal proportion of the sums owing to them. No binding insolvency procedures exist for governments that are unable to pay their debts.

2.10 This leads to a free-rider problem: one creditor can refuse to participate in the necessary debt reduction. Once others have reduced their claims by the necessary amount, and the debtor country's ability to repay recovers, the creditor that held out can pursue their debt claims for full value, at the expense of the debtor country – and, indirectly, at the expense of the other creditors.

2.11 A high-profile manifestation of this free-rider problem is when a company or fund buys defaulted debts at the low market value that prevails before debt relief, litigates to obtain judgment on their debts, waits until other creditors agree a reduction in their claims, and then pursues the debtor country's assets to realise the full value of the claim. Critics of this practice have labelled such litigators 'vulture funds'.

⁹ For this reason, repayment above the level that could sustainably be made to all creditors primarily constitutes an economic rent. It is likely that it generates rent-seeking behaviour as well as productive, wealth-creating activity, and that eliminating this rent will bring about a degree of efficiency benefit. This is discussed in the Impact Assessment at Annex A.

Box 2.B: Donegal International Ltd. v. Republic of Zambia

A prominent recent UK case of creditor litigation against a HIPC was Donegal v Zambia¹⁰, a judgment of the High Court in 2007. The debt in that case originally arose from Zambia to Romania in 1979. Romania agreed to lend Zambia up to \$15 million to purchase agricultural equipment, and other goods and services. Zambia defaulted and fell into arrears, and subsequent efforts to reschedule this debt under Paris Club terms failed. In 1999, Romania sold the debt to Donegal for approx. \$3.2 million, on a claim with a face value (including accumulated interest) of approx. \$30 million. Following the sale to Donegal, and in controversial circumstances, Zambia acknowledged the validity of Donegal's claims.

Donegal was incorporated in the British Virgin Islands, and its only asset was its claim against Zambia. In September 2002, after three years of unsuccessful negotiations, Donegal commenced litigation in the British Virgin Islands seeking compensation of around \$43 million. A settlement agreement (subject to English law) was reached in April 2003, in return for Donegal agreeing not to continue the British Virgin Islands legal proceedings. Under the agreement, Zambia agreed to pay \$15 million, plus additional interest payments. It also provided that, upon a default on these payments, Zambia would be liable for the full amount of principal and interest due under the original agreement, said to be approx. \$44 million, plus additional interest.

When Zambia failed to make payments in accordance with the payment schedule in the settlement agreement, Donegal issued proceedings in the High Court for more than \$55 million. The High Court ruled that Zambia had a real prospect of establishing that certain provisions of the settlement agreement were penal and therefore unlawful. The ultimate outcome was that Zambia's liabilities were assessed at approx. \$15 million. Under HIPC Initiative terms, Zambia could instead have expected 88 per cent cancellation of the debts it owed.

Credit markets

2.12 The Government supports maintaining a legal system that protects creditor rights and allows clear-cut action to address non-payment. The potential for litigation is a necessary feature of smoothly functioning markets. There are several reasons for this:

- not all debtors are co-operative and creditors should be entitled to protect their investment;
- creditors will factor into future lending decisions the scope they have to enforce their contractual rights if a debtor is unwilling to pay, and charge higher rates if this is uncertain; and
- the UK's status as a country with legal protection for creditors underpins its reputation as a jurisdiction of choice for investors, bringing consequential benefits to the domestic economy.

2.13 A liquid secondary market is also important to the supply of credit. Lenders are able to provide finance at lower rates of interest and with longer maturities if they expect to be able to sell on these assets to the secondary market if it becomes in their interest to realise their value.

2.14 Smoothly functioning financial markets can be of particular value for developing countries. Once they have the economic and public financial management capacity to sustain and

⁶ Donegal v Zambia, [2007] EWHC 197 (Comm.)

productively use non-concessional lending, it can provide a volume of capital investment that accelerates the pace of development and builds a virtuous circle of market confidence.

2.15 However, there are particular challenges involved in lending to sovereign (i.e. government) borrowers. In earlier centuries, a creditor's security depended more on its diplomatic influence or the borrowing government's need for new loans than on the capacity to sue the debtor for repayment. The last century saw a gradual move to a system where sovereign borrowers are subject to legal action if they default on their debts. This legal framework lessens the moral hazard problem of debtors that are able but unwilling to repay their loans. It has contributed in part to the great increase in international financial flows which have in turn contributed to economic growth in many developing countries.

2.16 A further challenge remains, arising from the collective action problem in the absence of rules to enforce equity of treatment from creditors if a country cannot repay its debts. Without a means to tackle the problem posed by non-participating creditors, the positions of other creditors and a fair and efficient solution may be undermined by those holding out. Markets have themselves responded to certain aspects of this problem. The high-profile success of some non-co-operative creditors and the increasingly difficult process of resolving sovereign debt crises has led to changes in the issuance of new bonds in emerging markets. New financing has been provided on terms that greatly limit the extent to which a single minority creditor can hold out for a higher settlement. Collective Action Clauses have been widely adopted in bonds and make a restructuring decision approved by a set supermajority of bondholders binding on all.

2.17 However, these developments have left the debt structure of most HIPC countries largely unchanged. Few of these countries have issued bonds and the great majority of their commercial debts are in forms that remain vulnerable to collective action problems. Problems related to those that creditor action has sought to address in new emerging market bonds thus remain unsolved for existing HIPC debts.

Government position

2.18 The UK Government has made clear its opposition to the practice of not participating in debt relief for HIPC countries and litigating for the full value of the debt. The Chancellor of the Exchequer stated on 10 May 2007: "I deplore the activities of so-called vulture funds that seek to profit from debts owed by the poorest countries in the world", and expressed determination to limit the damage done by such funds¹¹. The concern has been shared internationally, with the G7 group of leading nations stating its concern about the problem of aggressive litigation against HIPC countries. It welcomed the steps already taken by the Paris Club to address this problem, urged all sovereign creditors not to on-sell claims on HIPC countries, and committed to examine additional steps that might be taken.¹²

Actions so far

2.19 The UK has taken a lead in working for international agreement to measures to limit creditor non-co-operation in the HIPC Initiative. Several complementary approaches have been adopted and are helping to reduce the problem.

¹¹ Written Ministerial statement to the House of Commons, available at <http://www.publications.parliament.uk/pa/cm200607/cmhansrd/cm070510/wmstext/70510m0001.htm>

¹² Statement of G7 Finance Ministers and Central Bank Governors, Washington, October 2007

2.20 Firstly, if creditors that do recognise HIPC terms refuse to sell on the debts that are owed to them to non-participating creditors, this limits the capacity for other creditors to pursue full repayment. Many countries - Paris Club and EU members, and the signatories to the UN's Doha Declaration on Financing For Development¹³ - have all now made such a commitment.

2.21 Secondly, for those debts which are held by commercial creditors, the UK has played a major role in improving and funding the World Bank's Debt Reduction Facility. This mechanism helps debtor governments to resolve their commercial debts by providing an option to creditors of selling back their debts on HIPC terms. World Bank resources and donor contributions, including £10m from the UK Government, fund operations where an offer is made to commercial creditors of a particular HIPC to buy the debts on HIPC terms. Few debtor countries are in a position to make such an offer without the support of donors and the World Bank. The immediate redemption of a speculative and often illiquid investment, equality of treatment with other participating creditors and the opportunity to participate in the HIPC Initiative have proved attractive to many creditors. Over the past year, operations have been conducted for Mozambique, Nicaragua and Liberia. A number of extant judgments have also been cancelled in these operations.

2.22 In the case of Liberia, 97.5% of commercial creditors participated and sold their debts owed, worth a nominal \$1.2bn, at a 97% discount, the required reduction factor. However, even in this strikingly successful instance, the non-participating creditors continue to hold claims against Liberia worth 85% of the cost of the Debt Reduction Facility buybacks.

2.23 Finally, while Debt Reduction Facility offers are attractive to many creditors, some may continue to hold out for repayment above HIPC Initiative terms. The Government has acted with international partners to increase the difficulty of litigating for full repayment by ensuring that countries have the access they need to expert legal advice. The Department for International Development (DFID) has supported and part-funded the establishment of an African Legal Support Facility for African countries facing litigation on their debts. High-quality legal advice may be able to reduce the liability faced by countries, and the prospect of a more complex and protracted legal process may also make the option of holding out for high repayment less appealing to creditors. The Commonwealth Secretariat's HIPC Clinic has a similar purpose and approach.

Parliamentary activity

2.24 The Developing Country Debt (Restriction of Recovery) Bill was introduced in the House of Commons by Sally Keeble MP on 6 May 2009¹⁴. This proposal aimed to address the same problem of creditor non-co-operation as is considered in this consultation, although the scope proposed was considerably broader than that proposed here. The U.S. Congress is also currently considering legislation¹⁵.

¹³ Available at http://www.un.org/esa/ffd/doha/documents/Doha_Declaration_FFD.pdf

¹⁴ *Hansard*, 6 May 2009, column 175 <http://www.publications.parliament.uk/pa/cm200809/cmhansrd/cm090506/debtext/90506-0004.htm>
Bill text at <http://www.publications.parliament.uk/pa/cm200809/cmbills/091/09091.i-i.html>

¹⁵ Entitled the Stop VULTURE Finds Bill and most recently introduced in 2009 as H.R. 2932.

3

Purpose and scope

Reason for further action

3.1 There is evidence that the measures taken by the UK Government and international bodies to limit non-co-operative creditor activity have had some success, as described in the previous section. However, these methods cannot prevent creditors intent on pursuing their claims through the courts from doing so. So long as it remains possible and potentially highly profitable (depending on the price paid for the debt) to litigate for payment of the full value once other creditors have provided relief, some creditors are likely to take this route.

3.2 As a result, there continues to be a real threat that some HIPC countries will fail to fully benefit from debt relief, with these benefits instead being gathered by the minority of creditors adopting non-co-operative approaches. The Government believes that there are two reasons to be concerned by this:

- developmental – debt relief is an effective way to release resources to finance development. Litigating to seek full value repayment undermines relief granted by other creditors and weakens the financing position of heavily indebted poor countries; and
- fairness amongst creditors – non-co-operative creditors profit at the expense of sovereign and commercial creditors that do provide debt relief, some of which is provided at a public cost. The threat of non-cooperation by some creditors can also deter other creditors from participating in the initiative.

3.3 Even a single case of non-co-operation can be very costly for a debtor country with few resources and other urgent competing needs for spending. Debt relief is of great importance to these countries as part of the financing that will be required if they are to meet the Millennium Development Goals. As a result, the Government has considered possible steps to further reduce the scope for such creditors to reduce the benefits of debt relief. Importantly, these steps must not damage these countries' future access to commercial financing for development or cause other disproportionate negative consequences.

Extent of the problem

3.4 Information on the extent of litigation against HIPC countries to enforce debt is limited, as creditors do not identify and organise as a group. The principal systematic source of information is provided in the World Bank and International Monetary Fund (IMF)'s annual Status of Implementation Report on the HIPC Initiative. Countries within the Initiative are surveyed about litigation against them. The survey does not attempt to distinguish between claimants using any definition of the justifiability of the claim – for example, some claimants may be original lenders attempting to recover their loss, or creditors renewing their rights¹, rather than investors

¹ Limitation provisions may prevent a creditor from pursuing any claims unless legal action is initiated within a certain time period.

that bought the debt when the market price was low (i.e. before debt relief was granted) and intend to pursue repayment at full value.

3.5 The September 2008 version² gave the following results:

- 12 HIPCs have been targeted by litigation, with a total of 54 cases filed against them by litigating creditors;
- these creditors hold \$1.4bn of claims against HIPCs, and the courts have already given judgment on approx. \$1.2bn of that figure;
- of these 54 cases, 10 were heard in UK courts; and
- for the first time, no new case of litigation against HIPCs was reported in 2007/8, but existing cases remain and others may arise.

3.6 In the context of wider international financial flows, the \$4.3bn debt relief expected from commercial creditors within the HIPC Initiative is comparatively small. However, such debt relief expected from commercial creditors can constitute a significant proportion of the total debt relief expected by the heavily indebted poor country. In addition, the \$1.2bn value of claims already litigated against HIPCs is a significant proportion of the \$4.3bn total.

Question 1: Do you agree that there is a need for further action to tackle non-co-operative creditor litigation against Heavily Indebted Poor Countries?

Purpose of legislation

Box 3.A: Proposal for consultation

Under UK laws, holders of existing debts of Heavily Indebted Poor Countries will only be able to reclaim these debts up to a set level, unless the courts consider it just and equitable to order otherwise.

3.7 The purpose of such legislation would be to maximise the benefits of international debt relief by minimising the extent to which the HIPC Initiative can be undermined at the expense of poor countries and their other creditors, including UK citizens. Detailed design considerations are discussed in Chapter 4.

3.8 The Government proposes that legislation is tightly targeted at the existing stock of HIPC debt and allows the court some discretion over the level of payment to award. The Government's view is that designing the legislation in this way is necessary to minimise the risks to smoothly functioning financial markets whose importance was outlined in paragraphs 2.12-2.14. For example, legislation should not impose unnecessary costs on lending beyond the appropriate risk pricing, as this would lead commercial lenders to provide less new financing to the countries affected, or to demand higher rates of interest. If it did, the benefit to developing countries may be more than counterbalanced by the cost. The Government must also consider

² Available at: <http://www.imf.org/external/np/pp/eng/2008/091208.pdf>

the effect of legislation on the UK's financial services sector. A measure targeted so as to avoid significantly disadvantaging businesses operating in the UK or discouraging investment into the UK avoids these negative consequences.

3.9 Debt relief is an international issue and the problem of creditor non-co-operation also crosses borders. A complete solution would require international agreement. The Government has a strong record of international leadership on debt relief. If domestic legislation is taken forward then the Government would encourage international partners to consider similar measures. However, as domestic legislation should be effective for all qualifying debt contracts governed by UK laws, the Government's view is that a legislative approach would make a significant contribution to addressing creditor non-participation in the HIPC Initiative, even in the absence of international action. This should include the significant number of agreements where overseas parties have chosen English law to govern their agreements. Cross-border enforcement issues are considered in chapter 5.

Countries to which legislation should apply

3.10 There is potential for free-riding whenever a country restructures or defaults on its sovereign debts. These events have affected both low-income and middle-income countries. Legislation could therefore attempt to cover all developing countries' debts. However, the Government's view is that there are good reasons to target legislation solely at the debts of the 40 Heavily Indebted Poor Countries (HIPCs):

- for these countries, a clear international commitment exists to provide debt relief and reduce debt to sustainable levels;
- development and poverty reduction are explicit aims of the HIPC Initiative, in addition to the orderly restructuring that is the aim of all efforts to resolve defaulted debt. Debt relief is only provided once reforms are put in place to direct the benefits of relief at poverty reduction and growth;
- the HIPC Initiative provides a mechanism which assesses the level of debt reduction required from all creditors to restore sustainability, providing a clear standard to consider an individual creditor's action against;
- the level of reduction required to restore sustainability is generally very high for HIPCs, so the potential profit margin from not co-operating is correspondingly greater, as is the potential damage to the debtor country;
- many middle-income countries' commercial debts are now primarily in forms where other steps have been taken to reduce the scope for individual creditors to hold out and seek a preferential settlement. These measures, such as Collective Action Clauses, may prove effective; and
- the value of the commercial debts of HIPCs is a very small proportion – around 0.1 per cent – of total developing country borrowing. Legislation can strengthen debt relief without substantial effects on important and valuable wider capital flows to developing countries.

Question 2: Do you agree that any legislation should be targeted at the public debts of Heavily Indebted Poor Countries?

Application to new borrowing

3.11 Although international programmes seek to maintain the debt sustainability of HIPC countries once they have completed the Initiative, it is possible that some developing countries may again need to restructure or default on their debts incurred after this legislation comes into force. If that happens, there may again be scope for creditors to seek to profit through not co-operating. There might be further steps that could be taken now to reduce the extent to which new loans could be susceptible to this problem of non-co-operation in the event of default. Any such protection for the borrower would be expected to be priced into new lending. A successful measure would also need to address the problem of creditor co-ordination without increasing the moral hazard of a debtor choosing to default while being able to repay. However, the Government favours restricting the domestic legislation discussed in this consultation to debts contracted before the proposed legislation comes into force. A measure that applied to new lending would need to be taken with international agreement, as otherwise it could readily be avoided through choice of a different jurisdiction to cover new lending. This would be to the detriment of the UK's financial services sector without achieving its intention.

Question 3: Do you agree that any legislation should only apply to debts contracted before the legislation takes effect?

Costs and benefits of legislation

3.12 The consultation stage Impact Assessment attached at Annex A uses the evidence from the World Bank and IMF's survey of debtor countries to estimate the costs and benefits of the approach to legislation proposed, relative to continuing as at present. Further relevant evidence, particularly quantitative evidence, will be welcomed and can contribute to later stages of Impact Assessment if legislation or other new policy is progressed.

Question 4: Do you agree with the costs and benefits of legislating set out in the Impact Assessment?

Non-legislative options

3.13 The Government has also considered whether its aims could be met through non-legislative means. As set out in paragraphs 2.19-2.23, the Government has already taken vigorous action to reduce the scope for profitable non-co-operation, within the existing legal framework. Aside from the approach outlined above, relatively few alternatives remain open to further tackle the problem.

3.14 The operations of the World Bank's Debt Reduction Facility have recently had considerable success in reducing the commercial debts of HIPC countries. The Government strongly supports further operations and continues to fund the facility. However, the Debt Reduction Facility cannot address the problem posed by creditors determined to pursue a higher payout than that given by HIPC Initiative terms. By design, the Facility makes offers at these terms: countries providing relief under the Initiative are not willing to buy and cancel commercial debts on preferable terms

to that relief. Increasing funding for the Debt Reduction Facility would therefore not solve the problem.

3.15 Another possibility would be for responsible private creditors to establish a voluntary code of practice. This might, amongst other things, contain the commitment already made by many creditor countries not to sell on their HIPC debt contracts to creditors not co-operating in the HIPC Initiative, or to recognise the importance of comparability with HIPC Initiative relief. However, challenges would remain in securing the participation of creditors that might adopt a non-co-operative approach.

Question 5: Do you think that there is the possibility for further voluntary initiatives from commercial creditors of Heavily Indebted Poor Countries? If so, how effective would these be in increasing commercial co-operation in the HIPC Initiative?

Question 6: Are there other non-legislative measures that can be taken to address the problem?

4

Design of legislation

Possible approaches

4.1 The scope of the proposed legislation set out in the previous chapter clearly defines and delimits the Government's approach in terms of the debt covered. Within that stock of debt, there are several possibilities for the detailed design of legislation. The approach taken in legislation should deliver a fair balance between the aim of promoting debt relief for HIPC's, and the interests of different groups of creditors. The debts concerned are property rights protected by the Human Rights Act, and any legislation brought forward would have to provide for those property rights to be treated in a way that was consistent with the Act. This chapter of the consultation describes different choices available and seeks views.

Terms to apply

Applying HIPC Initiative terms

4.2 The Government currently urges all creditors of Heavily Indebted Poor Countries (HIPC's) to provide debt relief consistent with the HIPC Initiative. The Government is also a member of the Paris Club of major sovereign creditors. A condition of all Paris Club treatments or reductions of a country's debts is that the debtor country seeks comparable treatment (i.e. terms of restructuring) with its other sovereign and commercial creditors. This is designed both to ensure that the country gets the debt relief that it needs on economic grounds and to avoid the problem of free-riding. This equally applies to the Paris Club's implementation of HIPC Initiative terms with those countries. Government policy thus supports the full adoption of HIPC Initiative terms by all creditors. However, this is not legally binding.

4.3 One legislative approach would be to make HIPC Initiative terms the binding reference point for commercial creditors. Unless there is good reason to do otherwise (see paragraphs 4.12-4.15 below), legislation designed in this way would reduce the value that can be reclaimed on a debt owed by a heavily indebted poor country sovereign to that proportion of its full nominal value which is consistent with the HIPC Initiative. The advantage of this approach is that it uses an objective and widely recognised benchmark, set at a level calculated on the basis of returning all debts to a sustainable level if all creditors apply the terms. Through using a single benchmark, it creates clarity that different commercial creditors will be treated equitably with respect to one another.

4.4 A debt reduction is comparable with the HIPC Initiative if it achieves the reduction calculated as necessary by the IMF and World Bank in the net present value of the debt. This can be brought about through reducing its face value, rescheduling repayments over a longer period, or a combination. The reduction in net present value required is that given by the country's

Common Reduction Factor, applied after the provision of “traditional” relief at 67 per cent¹. Typically, the combined reduction required is around 90 per cent.

4.5 There are currently five countries which have yet to reach Decision Point under the HIPC Initiative – the Comoros, Eritrea, the Kyrgyz Republic, Somalia and Sudan. No international debt relief is being provided² and no Common Reduction Factor has yet been calculated. Estimating the level of reduction in their debts necessary to reduce them to a sustainable level is in general difficult, as detailed information on the level and terms of their debts will not have been compiled.

4.6 It is, however, clear that these countries will need significant levels of relief. To qualify for the Initiative, the countries each had in 2004 a debt burden large enough to exceed the sustainable limit set out in the HIPC Initiative, even after provision of “traditional” debt relief at 67 per cent. While the level of relief that will be required beyond this is not known, a relatively conservative assumption would be that 67 per cent relief will be needed.

4.7 If HIPC Initiative terms are to be used as the reference point for debt reduction post-Decision Point, a complementary approach would be to specify that courts should use 67 per cent as the benchmark for creditors litigating on debts of countries yet to reach Decision Point.

Preventing unjust enrichment

4.8 An alternative approach that has been proposed would reduce the claims of those creditors seeking to profit excessively from the recovery of the debt owed. This would protect all creditors’ legal scope to seek to reclaim the price paid for the debt plus a specified reasonable rate of interest. This design would be likely to lead to higher levels of recovery for most litigating HIPC creditors than would application of HIPC Initiative terms. This is the approach put forward in both the UK and US Bills.

4.9 Ensuring that any individual creditor remains entitled to a reasonable return on their investment could be argued to balance the position of that creditor and the benefits of full participation in debt relief. This approach would focus on preventing creditors earning high profits at the expense of debt relief, which constitutes the clearest contravention of international efforts. However, it would not ensure fairness between different creditors, two of which might be entitled to differing repayments on otherwise identical debts that were bought at different times. In addition, debtor countries would continue to be legally obliged to repay some commercial creditors at above HIPC terms, leading to a smaller development benefit and an outcome that may not be consistent with debt sustainability.

Question 7: What do you consider should be used as the reference point in specifying the maximum value that can be reclaimed from a debt covered by the legislation?

¹ The Enhanced HIPC Initiative was put into place as the final stage of debt relief for eligible countries and built on previous terms available. Under these “traditional” terms, countries could already receive 67 per cent relief on their debts under a so-called Naples treatment from the Paris Club. The Enhanced HIPC Initiative provides additional relief for those countries where this traditional relief is not enough to return debts to sustainability. As a result, the Common Reduction Factor is calculated as the additional reduction required once 67 per cent relief is provided. The correct reduction for creditors to apply is therefore the application of first a 67 per cent reduction and then the Common Reduction Factor, unless a creditor has already participated in providing relief on Naples terms.

² Although, under its own policy, the UK Government holds in trust any payments from these countries, to be returned to the country at Decision Point.

Application to original creditors

4.10 A second choice arises as to whether or not to exempt original creditors from the scope of legislation. Again, the clearest abuses of the debt relief process arise where buyers of HIPC debt at a low prevailing market price on the secondary market seek speculative reward through forcing repayment of the full value of the debt. This does not correspond to the situation of original creditors. Legislation could make binding the Government's preference that all creditors contribute to debt relief. Alternatively, it could include an exemption for original creditors. However, it is open to question whether the distinction that this separation would create between original creditors and those that purchased debt on the secondary market at close to full value is justifiable.

4.11 This choice is particularly significant if the reference point chosen is HIPC Initiative terms, rather than the price paid by the creditor. HIPC Initiative terms represent a considerable loss on the investment made by an original creditor. Responses are invited on the question of whether exempting original creditors would therefore be a fair recognition of their status.

Question 8: Do you think that original creditors should be specifically excluded from the scope of new legislation?

Court discretion to vary terms

4.12 While it would be possible to impose specified terms in all cases, the Government's initial view is that the courts should be granted discretion to order otherwise, if they consider it just and equitable to do so.

4.13 The Government believes it is merited to include a provision for discretion because there may be exceptional cases where circumstances provide particularly strong arguments for overriding the presumption in favour of the specified terms. This discretion would ensure that the court is always in a position to strike a fair balance between property rights and the wider public interest.

4.14 A provision for court discretion would not alter the Government's view that, as a matter of desirable policy, all creditors of HIPCs should provide debt relief comparable with the approach under the HIPC Initiative.

Question 9: Do you agree that legislation should include a provision to value debts above the terms specified, if it is found to be just and equitable to do so?

4.15 If legislation did give the courts discretion to vary their judgment, there is a further choice as to whether it should also specify factors they should take into consideration in their decision, or to leave that for the courts to take a view.

Question 10: What factors, if any, should be specified to consider in the use of discretion to value debts above the terms specified?

Debts contracted after Decision Point

4.16 The HIPC Initiative does not expect creditors to provide debt relief on debts contracted after a country reaches Decision Point. Once the country begins the process of debt relief, it is expected to manage new lending sustainably, and takes on new lending with no expectation of it being included in the HIPC Initiative. In addition to the exclusion of lending contracted after legislation comes into effect, lending already contracted post-Decision Point should therefore also be outside the scope of legislation.

Alternative or complementary legislative approaches

4.17 It is possible to consider other legislative routes that might aim at achieving the Government's policy intention.

4.18 Both the Bill brought forward in the UK under the Ten Minute Rule and the draft legislation before the U.S. Congress include provisions that would oblige creditors covered by the legislation to apply for permission from the courts to litigate, with a requirement to disclose information about all of those with a significant financial interest in the action. The rationale for such a provision is that those investors whose approach has been most widely considered unacceptable have also often adopted a secretive approach to their practices, and that a requirement for greater openness might have a deterrent effect. However, the Government is inclined to see such a provision on its own, without further measures, as insufficient to be a robust deterrent. At the same time, the Government's preferred legislative approach should be sufficient, without introducing an additional procedure and transaction cost.

Question 11: Do you think that any alternative or complementary legislative approaches would better accomplish the Government's purpose?

5

Operation and enforcement

5.1 The previous chapter discusses how to design legislation that would limit the recoverability of debts covered to achieve the Government's intended purpose. This chapter examines how such provisions could be put into practice so as to maximise the extent to which the amounts reclaimed by creditors in practice conform to the principle established by the law. Two particular aspects require attention – international issues and enforcement of claims on which a judgment has already been obtained.

Devolved administrations

5.2 The Government intends to enact any legislation throughout the UK. As the purpose of legislation is directed at international development and financial regulation, legislative consent will not be required, but comments on the impact of legislation in the context of the devolved administrations are welcome.

Enforcement of existing judgments

5.3 Of the \$4.3bn relief expected worldwide from commercial creditors of Heavily Indebted Poor Countries (HIPCs), \$1.2bn of claims have already seen a judgment awarded to the creditor, invariably at greater than HIPC Initiative terms. While definite information is not available, it appears likely that many of these judgments have not been fully enforced. Although some creditors may not intend to pursue the full settlement due, this volume of debt represents a significant threat to the financial position and development of the countries concerned. It is possible that more judgments may be obtained before any legislation can come into effect.

5.4 The Government's preference is therefore to make legislation apply to those qualifying HIPC debts on which judgment has already been obtained but not fully enforced, preventing the enforcement of those judgments above that which will be specified by the new legislation. It is unusual to alter the effect of judgments already given, but the Government considers there are pressing public policy reasons for taking that approach in this case¹.

Question 12: Do you agree that legislation should apply to those debts on which judgment has already been obtained?

¹ Legislation to alter the effects of judgments as regards the parties to those judgments is unusual, but there are precedents. In a recent example, Section 3 of the Compensation Act (2006) had the effect of reversing the judgment in *Barker v Corus UK Ltd (and conjoined cases)* [2006] UKHL 20. It concerned those with mesothelioma contracted after wrongful exposure to asbestos at several different times. Whereas the House of Lords had ruled that each of those responsible for the wrongful exposure were only liable according to their relative contribution to the chances of the person contracting the disease, the Act provided that each were jointly and severally liable for the full damages. The Act's application extended to those cases on which the courts had already reached judgment.

Cross-border enforcement

5.5 In principle, and subject to its international obligations, the Government's preference is for this policy to apply to cross border enforcement of debts, i.e. to enforcement within the UK of judgments gained outside the UK, and vice versa.

International action

5.6 Debt relief under the HIPC Initiative is an international effort whose effectiveness depends on co-operation between countries. The UK has led the international community, both in its own efforts and in working with other countries to participate to the maximum extent.

5.7 As noted in paragraph 3.9, domestic legislation should be effective for all debts governed by UK laws. However, not all non-cooperative creditors have debts under UK laws, leaving open the possibility of litigation in other jurisdictions. The Paris Club and European Union countries have made clear their opposition to profiting at the expense of debt relief. The UK government will continue to play a leadership role and will work with other countries to both highlight the importance of mitigating the impacts of non-cooperative creditors and encourage them to consider similar measures

Question 13: Do you agree with the Government's proposals relating to international aspects of legislation?

A Impact Assessment

The Impact Assessment follows overleaf.

Summary: Intervention & Options

Department /Agency: HM Treasury	Title: Impact Assessment of measures to address non-participation in debt relief	
Stage: Consultation Stage	Version: 1	Date: 13 July 2009
Related Publications: Ensuring effective debt relief for poor countries: a consultation on legislation		

Available to view or download at:

http://www.hm-treasury.gov.uk/consult_index.htm

Contact for enquiries: Dominic Curran

Telephone: 02072704553

What is the problem under consideration? Why is government intervention necessary?

International debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative is returning the finances of 40 countries to sustainability and releases money to reduce poverty and spur economic growth.

As the Initiative is voluntary, some investors are buying eligible debts and, instead of providing relief, suing the debtor country for full repayment. This poses a free-rider problem to efficient and equitable relief, reducing its benefits. The measures already taken to limit this problem have had some effect but the risk remains and creates a case for further Government intervention.

What are the policy objectives and the intended effects?

New policy aims to further reduce the extent to which holders of debts of HIPCs can profit from demanding repayment above the rate at which other creditors are providing relief. It intends to find a way of doing so that is fair to all with an interest, consistent with their rights, and which avoids negative effects on the environment for future financing to developing countries and the UK's competitiveness as a financial centre.

What policy options have been considered? Please justify any preferred option.

Option (1) - legislation to reduce the value of existing debts of HIPCs, excluding those on which judgments have been awarded.

Option (2) - legislation affecting existing debts, including those on which judgments have been awarded. This is the preferred option as it will be most effective in achieving the objective, while tight targeting leaves the status of all future lending and lending to other countries unchanged.

Option (3) - voluntary code of practice

Option (4) - existing approaches only

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The Government keeps all legislation under review. In line with good practice, if legislation is enacted then the Government would expect to review the policy within three years.

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:



.....Date: 20/07/2009

Summary: Analysis & Evidence

Policy Option: 1 Legislation	Description: Legislation affecting only existing debts on which judgements have not yet been made.
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' Principal cost is a transfer of between zero and £33.2m per year from creditors not participating in debt relief who would otherwise be able to extract this level of payment above HIPC terms. Also includes est. £1m transaction cost from increased litigation costs.				
	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%; padding: 2px;">One-off (Transition)</td> <td style="width: 30%; text-align: center; padding: 2px;">Yrs</td> </tr> <tr> <td style="padding: 2px;">£ 0</td> <td></td> </tr> </table>		One-off (Transition)	Yrs	£ 0	
	One-off (Transition)		Yrs			
	£ 0					
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%; padding: 2px;">Average Annual Cost (excluding one-off)</td> <td></td> </tr> <tr> <td style="padding: 2px;">£ 1 - 34.2m</td> <td></td> </tr> </table>	Average Annual Cost (excluding one-off)		£ 1 - 34.2m			
Average Annual Cost (excluding one-off)						
£ 1 - 34.2m						
Total Cost (PV)		£ 189 million				
Other key non-monetised costs by 'main affected groups' Potential cost to UK financial and legal services if litigation taken to other jurisdictions (likely to be limited as parties may have agreed that jurisdiction for disputes will be within the UK).						

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' Direct benefit is an equal transfer of between zero and £33.2m per year to Heavily Indebted Poor Countries.				
	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%; padding: 2px;">One-off</td> <td style="width: 30%; text-align: center; padding: 2px;">Yrs</td> </tr> <tr> <td style="padding: 2px;">£ 0</td> <td></td> </tr> </table>		One-off	Yrs	£ 0	
	One-off		Yrs			
	£ 0					
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%; padding: 2px;">Average Annual Benefit (excluding one-off)</td> <td></td> </tr> <tr> <td style="padding: 2px;">£ 0 - 33.2 mn</td> <td></td> </tr> </table>	Average Annual Benefit (excluding one-off)		£ 0 - 33.2 mn			
Average Annual Benefit (excluding one-off)						
£ 0 - 33.2 mn						
Total Benefit (PV)		£ 183 million				
Other key non-monetised benefits by 'main affected groups' (1) HIPC can use transfer for poverty reduction and, through eliminating debt overhang, higher growth (2) Benefit of fairness amongst creditors (3) consequent further incentive for creditor participation, increasing benefits to the HIPCs (4) preventing free riding eliminates an economic rent						

Key Assumptions/Sensitivities/Risks Assumes HIPC Initiative completed 6 years from now, so 6 year time horizon used, after which all costs and benefits expire. Totals are upper bounds due to uncertainties around proportion of commercial debts that will be affected and use that courts will make of discretion, as described in the evidence base.

Price Base Year	Time Period Years 6	Net Benefit Range (NPV) £ -10 - 0 million	NET BENEFIT (NPV Best estimate) £ -6 million
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What is the geographic coverage of the policy/option?	UK and HIPCs				
On what date will the policy be implemented?	N/A				
Which organisation(s) will enforce the policy?	-				
What is the total annual cost of enforcement for these organisations?	£ 0				
Does enforcement comply with Hampton principles?	Yes				
Will implementation go beyond minimum EU requirements?	Yes				
What is the value of the proposed offsetting measure per year?	£ NA				
What is the value of changes in greenhouse gas emissions?	£ NA				
Will the proposal have a significant impact on competition?	No				
Annual cost (£-£) per organisation (excluding one-off)	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">Micro N/A</td> <td style="width: 25%; text-align: center;">Small N/A</td> <td style="width: 25%; text-align: center;">Medium N/A</td> <td style="width: 25%; text-align: center;">Large N/A</td> </tr> </table>	Micro N/A	Small N/A	Medium N/A	Large N/A
Micro N/A	Small N/A	Medium N/A	Large N/A		
Are any of these organisations exempt?	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">N/A</td> <td style="width: 25%; text-align: center;">N/A</td> </tr> </table>	No	No	N/A	N/A
No	No	N/A	N/A		

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of £ 0	Decrease of £ 0	Net Impact £ 0

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Summary: Analysis & Evidence

Policy Option: 2 Legislation	Description: Legislation to reduce the value of existing debts of HIPCs, including those on which judgement has been awarded.
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' As in Option 1 but with both the value of the transfer from non-participating creditors and the transaction cost increased. Transfer of between zero and £44.2m per year from non-participating creditors which would otherwise be able to extract this from HIPCs. £2.3m per year legal transaction cost.		
	One-off (Transition) Yrs			
	£ 0			
	Average Annual Cost (excluding one-off)			
	£ 2.3 - 46.5m	Total Cost (PV)	£ 256 million	
Other key non-monetised costs by 'main affected groups' As above.				

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' As in option 1 but with the value of the transfer to Heavily Indebted Poor Countries increased to between zero and £44.2m per year through inclusion of cases on which a judgment has been obtained.		
	One-off Yrs			
	£ 0			
	Average Annual Benefit (excluding one-off)			
	£ 0 - 44.2m	Total Benefit (PV)	£ 244 million	
Other key non-monetised benefits by 'main affected groups' As above.				

Key Assumptions/Sensitivities/Risks As above, and assume even distribution of cases affected by backdating over the 6 year period.

Price Base Year	Time Period Years 6	Net Benefit Range (NPV) £ -20 - 0 million	NET BENEFIT (NPV Best estimate) £ -12 million
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What is the geographic coverage of the policy/option?	UK & HIPCs			
On what date will the policy be implemented?	N/A			
Which organisation(s) will enforce the policy?	-			
What is the total annual cost of enforcement for these organisations?	£ 0			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	Yes			
What is the value of the proposed offsetting measure per year?	£ NA			
What is the value of changes in greenhouse gas emissions?	£ NA			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro N/A	Small N/A	Medium N/A	Large N/A
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of	£ 0	Decrease of	£ 0
Net Impact			£ 0

Key: Annual costs and benefits: (Net) Present

Summary: Analysis & Evidence

Policy Option: 3 Voluntary Code	Description: Voluntary Code of Practice led by responsible creditors
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' NA		
	One-off (Transition) Yrs			
	£ 0			
	Average Annual Cost (excluding one-off)			
	£ 0	Total Cost (PV)	£ 0	
Other key non-monetised costs by 'main affected groups' Potentially a cost of compliance to commercial creditors of HIPC debt.				

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' NA		
	One-off Yrs			
	£ 0			
	Average Annual Benefit (excluding one-off)			
	£ 0	Total Benefit (PV)	£ 0	
Other key non-monetised benefits by 'main affected groups' NA				

Key Assumptions/Sensitivities/Risks Yet to be a proposal from creditor groups for a voluntary code restricting the selling on of debts to non-co-operative creditors, so no evidence currently available to assess costs and benefits as differing from baseline case.

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £ 0
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What is the geographic coverage of the policy/option?	UK & HIPCs			
On what date will the policy be implemented?	N/A			
Which organisation(s) will enforce the policy?	Market participants			
What is the total annual cost of enforcement for these organisations?	£ Unknown			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	Yes			
What is the value of the proposed offsetting measure per year?	£ NA			
What is the value of changes in greenhouse gas emissions?	£ NA			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro N/A	Small N/A	Medium N/A	Large N/A
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)	
Increase of £ 0	Decrease of £ 0	Net Impact	£ 0

Key: Annual costs and benefits: (Net) Present

Summary: Analysis & Evidence

Policy Option: 4 No Action	Description: Continue as before. This is the baseline against which other options are assessed.
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' N/A		
	One-off (Transition) Yrs			
	£ 0			
	Average Annual Cost (excluding one-off)			
	£ 0	Total Cost (PV)	£ 0	
Other key non-monetised costs by 'main affected groups' N/A				

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' N/A		
	One-off Yrs			
	£ 0			
	Average Annual Benefit (excluding one-off)			
	£ 0	Total Benefit (PV)	£ 0	
Other key non-monetised benefits by 'main affected groups' N/A				

Key Assumptions/Sensitivities/Risks Assumes creditors can continue to benefit at the expense of HIPC's. Existing action to increase participation assumed to continue: commitment not to sell on claims on HIPC countries to creditors not participating in the HIPC initiative, and use of World Bank Debt Reduction Facility (DRF) and African Legal Support Facility.

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £ 0
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What is the geographic coverage of the policy/option?	NA
On what date will the policy be implemented?	NA
Which organisation(s) will enforce the policy?	NA
What is the total annual cost of enforcement for these organisations?	£ 0
Does enforcement comply with Hampton principles?	Yes/No
Will implementation go beyond minimum EU requirements?	Yes/No
What is the value of the proposed offsetting measure per year?	£ NA
What is the value of changes in greenhouse gas emissions?	£ NA
Will the proposal have a significant impact on competition?	Yes/No
Annual cost (£-£) per organisation (excluding one-off)	Micro 0 Small 0 Medium 0 Large 0
Are any of these organisations exempt?	No No N/A N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of £ 0	Decrease of £ 0	Net Impact £ 0

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

Analysis and Evidence

The evidence is based upon the information provided in the World Bank and International Monetary Fund (IMF)'s most recent Status of Implementation Report on the HIPC Initiative, published in September 2008. This reports upon the amount of debt relief delivered and remaining to be provided from commercial creditors under the Initiative. It also reports on a survey conducted by the International Financial Institutions of debtor countries concerning litigation against them on their debts. The survey does not attempt to distinguish between claimants using any definition of the justifiability of the claim - for example, some claimants may be original lenders attempting to recover their loss, or creditors renewing their rights, rather than investors that bought the when the market price was low and intend to pursue repayment at full value.

Analytical approach

The estimated costs and benefits of the legislative options (options 1 and 2) relative to the base case contain two elements:

1. a transfer of resources from litigating creditors to Heavily Indebted Poor Countries. The purpose of legislation would be to reduce the extent to which creditors can secure settlements at terms above the common reduction specified in the HIPC Initiative as that required to return the country's debts to sustainability. The direct effect is a benefit to the HIPC and an equal cost to the litigating creditor; and
2. a transaction cost arising from the increased complexity of law in this area that would result from legislation.

Key assumptions in the analysis

The limited nature of the evidence that can be gathered on creditor litigation necessitates some assumptions in modeling its extent:

- amount of debt relief yet to be delivered by commercial creditors – the Status of Implementation Report provides values for the cost to commercial creditors of providing HIPC Initiative relief. There is also a cost in providing “traditional” debt relief (see paragraph 4.4 of the consultation document). No information is available on the proportion of this traditional relief that has been provided by commercial creditors and so the analysis solely considers the costs and benefits of the provision of HIPC Initiative relief itself;
- terms to apply – the consultation presents options on whether HIPC Initiative terms should be applied by creditors, or an unjust enrichment approach; and asks whether or not to include original creditors. For the purposes of an upper bound, the more comprehensive options of HIPC terms and application to all creditors is used;
- proportion of commercial debt yet to be litigated on that will be subject to litigation – it has not proved possible to estimate in the base case what proportion of remaining commercially-held debt will be the subject of litigation. The proportion of the commercial debts of post-Completion Point countries' commercial debts that has been litigated does not provide a reliable indicator for countries at an earlier stage of the process as there have already been a higher proportion of debts litigated on for pre-Completion Point countries;
- proportion of judgments on which a litigating creditor will, in the absence of legislation, attempt to secure assets equaling the full value of the debt – some creditors may litigate to obtain judgment on the debt, but may not necessarily intend to enforce in full. No information on enforcement actions is available to quantify this; and

- proportion of cases litigated under new legislation where the courts would exercise discretion to vary judgments from HIPC terms – the legislation proposed in options 1 and 2 would give courts discretion to make whatever judgment they consider just and equitable, and it would be difficult to pre-judge how widely this discretion might be used.

The last three points lead to the adoption of a methodology that calculates a range of values for the transfer from litigating creditors to HIPCs, with an upper bound that assumes the maximum effect for each of these and a lower bound of zero.

Non-monetised benefits of legislative options

The purpose of legislation would be to benefit HIPCs at the implicit cost of those creditors that may otherwise be able to receive excessive award on the debts owed to them, above the common reduction factor necessary to restore sustainability to these debts. The primary effect is a transfer, but there are a number of reasons why such a transfer would be economically beneficial:

- the provision of debt relief at a common rate by all creditors would eliminate the free-rider problem where a few creditors obtain rewards above the settlement which all must provide for the debts to become repayable. This has three benefits. Firstly, as the common reduction factor is economically based and calculated at the level where debts become sustainable, one creditor failing to provide this relief reduces the repayment prospects for those creditors that do provide relief at the expected level. Secondly, it has an equity benefit amongst creditors by ensuring that all provide an equal level of relief. Thirdly, this equity may also improve efficiency, through removing a disincentive to the participation of other commercial creditors in debt relief;
- the payback that can be obtained by holding out for a higher settlement is in large part an economic rent, and the behaviour it induces is likely to be rent-seeking rather than economically productive. Eliminating this rent may therefore be expected to lead at least in part to efficiency benefits that offset the direct loss. Bhagwati's discussion of "directly unproductive, profit-seeking activities" (*Journal of Political Economy*, Vol. 90, No. 5 (Oct 1982) pp. 988-1002) is relevant in this context; and
- there are equity and potentially efficiency benefits in the greater provision of resources for HIPCs that would come about through full implementation of the HIPC Initiative resulting from a legislative approach. The countries concerned all have high levels of poverty, as only countries with a mean annual per capita income below \$1,095 may qualify for relief. Debt relief is provided in the context of poverty reduction programmes aimed at achievement of the Millennium Development Goals. Efficiency arguments for debt relief include analysis of debt overhang, where old defaulted loans deter new investments that would be of net benefit to both borrowers and lenders.

Costs

Option 1:

Increased transaction costs are expected as a result of the legislation, due to raised legal fees. This legislation would give an extra legal defence to HIPCs, and may lead to increased litigation costs, particularly in the first few cases as caselaw is developed on the meaning of 'just and equitable'. A per case estimate of up to £1million extra legal fees is used from indications of market participants. An estimate of the likely number of future UK cases, based on the average value of UK claims as a proportion of the remaining HIPC debt relief with commercial creditors (from multiplying the UK proportion of the global value of existing claims, 20%, by the \$1.95billion of HIPC debt relief cost with commercial creditors that has not yet been claimed on with a judgement awarded), is 6. The estimated annual average cost is then attained by dividing the total transaction costs over 6 years, the assumed time period required for completion of the HIPC Initiative.

The additional annual average cost listed consists of £33.2million for 6 years. This is an upper bound estimate of the remaining HIPC debt relief with commercial creditors yet to be delivered (so vulnerable to creditor litigation for full value) and likely to be under UK jurisdiction (based on the 20% of existing claims by value already heard in the UK), using the IMF figure of \$1.95 billion of HIPC debt with commercial creditors not yet claimed on and settled (further adjusted to take into account the most recent data on DRF operations after the September 2008 report). 2007 exchange rates are used.

Whilst this does represent a cost to creditors that would have sought terms more favourable than those of the HIPC Initiative, it is a transfer, so is also listed in the benefits section, as it is received by HIPCs.

Option 2:

This option includes the application of legislation to cases where judgement has already been given, adding additional transaction costs to the settlement of those cases.

Similar methodology to that in Option 1 is used to estimate transaction costs for the 8 existing UK cases where judgement has already been awarded, again spread over 6 years, and added to the estimated average annual transaction costs for debt relief not yet claimed.

Additional costs imposed on creditors seeking preferential settlements are estimated to equal £11million per annum over 6 years. This is based on the \$126 million awarded to creditors already in UK courts, converted using 2007 exchange rates as above. As before, this represents an upper bound, as it implicitly assumes zero recovery of funds has occurred by creditors at the introduction of the legislation.

Option 3:

Costs are estimated as zero for the voluntary code of practice option, as there is yet to be a proposal from market participants for such a scheme and no evidence of what any such scheme's effectiveness might be.

Option 4:

Baseline case costs are defined to be zero as there is no additional policy action taken.

Benefits

Option 1:

Average annual benefits of £33.2 million per annum over 6 years represent the estimated maximum commercial creditors refusing to participate in debt relief can obtain from HIPC debts through UK courts. This is calculated using the total cost of HIPC debt relief with commercial creditors yet to be delivered, as described in the cost section for Option 1. If legislation were enacted and prevented these claims at above HIPC Initiative levels, the result would be a transfer to the benefit of the HIPC.

Option 2:

The additional average annual benefits of £11 million are the upper estimated benefits to HIPCs of enforcement of HIPC Initiative terms on commercial creditors. This is equal and opposite to the cost imposed on commercial creditors, and the calculation is described in the costs section under Option 2.

Option 3:

Benefits of a voluntary code of practice are currently estimated to equal zero, in the absence of evidence or proposals otherwise.

Option 4:

This option assumes no action, so benefits are defined to equal zero. However, this still assumes continuation of existing measures to limit the ability of commercial creditors of HIPC debt to recover the full nominal value, including:

Commitment not to sell on claims on HIPCs to creditors not participating in the HIPC Initiative, and use of the World Bank Debt Reduction Facility (DRF) and African Legal Support Facility.

Equality impacts

None of the options considered would discriminate on the basis of race, gender or disability. International debt relief contributes to progress towards the United Nations' Millennium Development Goals, which seek to reduce extreme poverty and include a specific goal of eliminating gender disparity in education. Options 1 and 2 are judged to have the potential to make a positive contribution to global gender equality.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	No	No
Small Firms Impact Test	No	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	No	No
Rural Proofing	No	No

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