4

Standard-Setting and Organizational Resilience

The Case of the Institute of International Finance

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4.1 INTRODUCTION

The fundamental challenges faced by the management of financial trade associations are retaining existing members and attracting new ones. The management's ability to do that defines the long-term success and resilience of such organizations. Not all associations are successful in achieving that goal. In the early 2000s, as many as six trade associations brought together the various creditors of sovereign debt.[1] Only three of them still exist today, and the Institute of International Finance (IIF) is by far the most influential among them; it has over 450 members that fund its activity. How did the IIF manage to hold on to its members and even expand its membership?

The IIF has emerged in the wake of sovereign defaults of the 1980s as an organization entrusted with monitoring sovereign borrowers. Its influence started to wane as sovereign markets appeared to have healed, mainly due to the Brady plan.[2] IIF's membership started to decline as member institutions have begun to

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[1] The group, frequently referred to as the "Gang of Six," comprised the following associations: the Emerging Markets Creditors Association (EMCA), the Emerging Market Traders Association (EMTA), the IIF, the International Primary Market Association (IPMA), International Securities Market Association (ISMA), Securities Industry Association (SIA), the Bond Market Association (BMA). In 2005, IPMA merged with the ISMA to form the International Capital Market Association (ICMA).

[2] The Brady plan, named after then US Treasury Secretary Nicholas Brady, allowed countries to exchange their commercial bank loans for bonds guaranteed by multilateral lenders, in particular the IMF and the World Bank. J. Sachs, Making the Brady Plan Work (1989) 68 *Foreign Affairs* 87.

question the return on the investment associated with maintaining their membership in the IIF. By all accounts, the IIF was experiencing an existential crisis. Its continued viability as the voice representing private creditors of sovereign debt was uncertain.

IIF's management successfully steered the organization through those uncertain times. Recent literature, particularly the work of two political economists, Abraham Newman and Elliot Posner, has suggested that the IIF's continued success can be attributed to a combination of exogenous and endogenous factors.[3] In the IIF's case, the emergence of a new paradigm for banking regulation brought about by the Basel Accords created a new role for the organization in terms of regulatory advocacy. On the endogenous side, management capable of identifying opportunities for the expansion of the organization's influence was vital to leverage the considerable experience of the IIF with the collection of information, to help it established itself as a credible contributor to the policy work at the Basel Committee on Banking Supervision.

Newman's and Posner's analysis suggests three strategies of organizational resilience that help explain the IIF's success story. First, timely identification of new constituencies that can help support the work of the organization. Second, a reorientation toward new activities, specifically transnational policy advocacy in the realm of banking regulation. Third, the adaption of an internal governance mechanism to accommodate new members and facilitate new activities. Together, Newman and Posner argue, these strategies were critical for the continued relevance of the IIF.

In this chapter, I argue that standard-setting is another strategy adopted by the IIF to maintain relevance. The IIF adopted the strategy of standard-setting in the wake of new regulatory initiatives promoted in the sovereign debt space in the early 2000s. Despite the optimism that the Brady plan injected into sovereign debt markets, problems have not disappeared from those markets. Those problems have been the catalyst for a set of proposals aimed at establishing an official sector bankruptcy-like mechanism to facilitate sovereign debt restructurings known as the Sovereign Debt Restructuring Mechanism (SDRM). For fear of the impact this could have on public sector participation, the IIF, together with the other associations, opposed establishing the SDRM.[4]

The alternative to the SDRM proposal discussed consisted of contractual standards, which the IIF helped to define and endorsed. The standards set, among other things, thresholds of creditor participation aimed at ensuring that a small group of creditors does not undermine the efforts of the rest to restructure or write-off a

[3] A. Newman and E. Posner, Structuring Transnational Interests: The Second-Order Effects of Soft Law in the Politics of Global Finance (October 18, 2016) *Review of International Political Economy* 768.

[4] EMCA, EMTA, IIF, IPMA, ISMA, SIA, BMA, Sovereign Debt Restructuring (Discussion Draft, December 6, 2002).

portion of a piece of distressed sovereign debt. The IIF also played an essential role in developing the Principles for Stable Capital Flows and Fair Debt Restructuring, a code of conduct for the various actors in the sovereign debt market. Two informal groups comprising members from both the public and the private sector to which the IIF serves as a secretariat were entrusted with monitoring the implementation of the Principles.

My main argument in this chapter is that, by endorsing and in part also creating that framework, the IIF created the structural conditions for its continued relevance in the sovereign debt space. The IIF's continued relevance is evidenced by its role in shaping the private sector's response to the looming sovereign debt crisis induced by the COVID-19 pandemic, which I also describe in this chapter. Recognizing that the crisis undermined the ability of many emerging countries to service their external debt, the IIF called on its members to refrain from enforcing the contracts and join the Debt Service Suspension Initiative (DSSI) – an ad hoc regulatory instrument promoted by the G20 Finance Ministers and Central Bank Governors. Still, the IIF insisted that private creditor participation should be voluntary. What was the result? At the time of writing (March 2021), over forty-six countries have taken advantage of the debt relief under the DSSI. However, most of that relief came from public creditors; private creditor participation in the DSSI has been minimal.

By creating the structural conditions for its relevance by endorsing or developing standards, the IIF's management has shown an entrepreneurial attitude that has remained largely neglected in the extant theoretical literature. The analytical framework developed by Newman and Posner and developed further here can help us understand the dynamics of resilience of trade associations. However, it also prompts questions about normative standards through which to view that resilience. When are the activities of such associations beneficial, and when do they create social costs? To the extent they create costs, what degree of control do public policymakers have over the activities of such associations? What are the channels through which public policymakers can exercise such control?

4.2 A BRIEF HISTORY OF THE IIF'S ECONOMIC ACTIVISM

4.2.1 *IIF in the 1980s: Addressing the Information Gap in the Sovereign Debt Market*

The IIF was established in 1983 in response to the perceived deficiencies in the structure of the sovereign debt market increasingly populated by private creditors.[5]

[5] For an early account of the origins of the IIF, see W. S. Surrey and P. N. Nash, Bankers Look beyond the Debt Crisis: The Institute of International Finance, Inc. Perspectives (1985) 23:1

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Around that time, several sovereign borrowers, most notably Mexico, Brazil, Argentina, and Poland, experienced problems servicing their external debt. Their perilous situation prompted concerns about the nature of private creditor participation in any future restructuring of the debt of those countries and private creditors' role in the market more generally.

The IIF was formed as a result of a meeting organized by a group of policy-makers affiliated with the Committee on Changing International Relations, a committee of the National Planning Association (NPA), a US think tank established in the 1930s. The group brought together representatives of commercial banks involved in sovereign lending to discuss the situation. As recounted by Walter Sterling Surrey, the IIF's first general counsel, and Peri N. Nash, the group identified four major deficiencies: (1) the information made available by the borrowing countries to public lenders, such as the International Monetary Fund (IMF), was typically made available on a confidential sovereign-to-sovereign basis and therefore not readily available to commercial banks, (2) the information was often outdated, (3) the leading commercial banks developed their analyses but did not like to share it with other institutions, and (4) there were no uniform reporting standards.

Discussions about the structure of a new institution were held in New York in the summer of 1982 and brought together some thirty-one major banks from the United States, Japan, the United Kingdom, France, Canada, the Netherlands, the Federal Republic of Germany, and Switzerland as well as representative from the World Bank, the IMF, the Bank for International Settlements, the Bank of England, and the NPA. It was at that meeting that the IIF's Articles of Incorporation had been drawn. Pursuant to the document, the purpose of the IIF was

> to form an organization of commercial banks to promote a better understanding of international lending transactions generally; to collect, analyze and disseminate information regarding the economic and financial position of particular countries which are substantial borrowers in the international markets to provide the Members with a better factual basis on which each member independently may analyze extensions of credit to borrowers in such countries; and to engage in other appropriate activities to facilitate, and preserve the integrity of, international lending transactions.[6]

Columbia Journal of Transnational Law 111. The information about the origins of the IIF in Section 4.2.1 is derived mainly from that article.

6 Articles of Incorporation of the Institute of International Finance, Inc., art. third (January 11, 1983).

The Articles also provided that the IIF would be a nonprofit corporation located in Washington, DC. Its membership would comprise commercial banks active in the market for sovereign debt. The members' voting powers in matters pertaining to the organization's activities would be proportionate to the magnitude of the member's exposure to sovereign debt. A small staff would manage the day-to-day operations of the IIF. The IIF would also seek to facilitate the exchange of views among members through the organization of working groups.

IIF's work in the areas identified above would prove valuable during times of sovereign crises, such as those of the early 1980s. Still, it was not as clear what the benefit of retaining membership would be outside of the context of a challenging macroeconomic environment that typically acts as a catalyst for the emergence of such crises. The future validated those concerns. As noted in an empirical study by Newman and Posner, the Brady Plan of 1989 had resolved much of the debt crisis, and many small commercial banks had left the organization or merged with bigger banks. At the same time, the IMF and Bank of International Settlements (BIS) gradually opened up information to private actors, undercutting the value of IIF surveillance activities. US bank representation fell from 40 banks in 1987 to 18 by 1993. Overall membership declined from 167 full members in 1987 to 135 members in 1991. "By its own account, the organization faced a crisis in the late 1980s as its primary mission had evaporated."[7]

4.2.2 *IIF in the 1990s: Shaping the New Paradigm of Banking Regulation*

The evolving political economy of banking regulation in the wake of revisions to the first Basel Accord of 1988 created a unique opportunity for the organizational revival of the IIF. The first Basel Accord broke ground in that it represented the first-ever international effort at coordinating banking regulation. Still, that Accord is commonly viewed as having been the product of mainly national actors, particularly central banks.[8] Commercial banks, the principal target of the first Accord, may have sought to influence the final shape of the first Accord. However, they did that through national channels rather than directly by seeking to influence the Basel Committee for Banking Supervision (BCBS) – the body established and entrusted with the task of developing the Accord. Only when the proposal for the second Accord was floated did banks seek to exert a greater degree of influence

[7] Newman and Posnner, *supra* note 3, at 782.

[8] C. Goodheart, *The Basel Committee on Banking Supervision: A History of the Early Years 1974–1997* (2011) (quoted in Newman and Posnner, *supra* note 3, at 780).

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over its shape by lobbying the BCBS directly.[9] This was partly because Basel II was directed at activities of investment banks, many of which operated on a global basis. The IIF identified the opportunity to represent them and sought to capitalize on it.

Targeting large investment and money center banks as potential new members was the first strategy of the IIF identified by Newman and Posner aimed at the organizational revival of the IIF. The second strategy consisted of the comprehensive reorienting toward transnational regulatory policy efforts. As Newman and Posner note, the second strategy followed directly from the first.

> Having identified investment and money center banks as their primary new member targets, IIF's leaders sought to enhance the organization's relevance to these banks' new concerns about the Basel Committee's expanding regulatory agenda. The strategy meant that the IIF would have to engage the new transnational rulemaking arena directly and would have to add a regulatory advocacy dimension to its traditional functions.[10]

In 1990, under the leadership of Managing Director Schulmann, the IIF formally altered its mission statement to broaden its goals, thereby hoping to appeal to a broader set of firms than those it sought to represent in the early days of its existence on matters pertaining to the sovereign debt market. That shift was also reflected in the appointment of a different group of people to its management. As Newman and Posner note, the appointment of Charles Dallara, a long-time US Treasury Department official, was an excellent example of that.[11] Crucially, as they note, the management of the IIF itself initiated that shift. In other words, it was not in another substantial way the result of pressure from the industry. The management also anticipated reluctance from the public sector to engage with the organization

[9] M. K. Borowicz, The Internal Ratings-Based and Advanced Measurement Approaches for Regulatory Capital Under the Basel Regime, in *The Governance and Regulation of International Finance* (G. P. Miller and F. Cafaggi eds., 2013).

[10] Newman and Posnner, *supra* note 3, at 784.

[11] In their discussion, Newman and Posner include the following except from an official IIF document commemorating its first twenty-five years of existence:

> The Board recognized at this time that such a bold regulatory thrust may have a particular appeal to some of the very large banks that had still not joined the Institute .... A broader agenda of the IIF activities and events was seen as part of the strategy to attract these banks .... The challenge to the new Managing Director was to find more effective ways to keep the IIF relevant, to expand its influence and to revitalize its membership. Dallara's response came quickly. In the fall of 1993, following intensive discussions with the IIF's Board of Directors, he forged a new agenda for the Institute that would involve increased advocacy ...." Institute of International Finance, *IIF History Book: The First 25 Years* (2007) (quoted in Newman and Posnner, *supra* note 3, at 784.

on the advocacy front. This is why the shift was implemented carefully and gradually.

The third strategy of adaptation identified by Newman and Posner consists of governance changes. The new focus on advocacy informed the design of internal operations of the IIF. In 1991, the IIF created a working group on capital adequacy.

> Contrary to arguments attributing organizational priorities to the material interest of industry, the IIF's agenda shift was a reaction to Basel I rather than in anticipation of it. The aim of the IIF's leaders in revamping the internal organizational structure was to make the IIF a better interlocutor with Basel and a source of expertise, rendering it more effective as an industry advocate and, ultimately, more attractive to new members.[12]

The strategies of adaptation proved to be successful. The IIF became the BCBS' most influential adviser in large part due to its proven track record to collect information on a confidential basis. Around that time, the industry was increasingly embracing quantitative approaches to finance and relying on risk modeling. The BCBS was keen to build on that expertise, but its access to information about how banks used those models was limited. As Newman and Posner note, the IIF positioned itself as a supplier of that information, which proved instrumental for incorporating the internal risk models into the Basel II framework.

4.2.3 *IIF in the 2000s: Strengthening the Contractual Framework for Sovereign Debt Restructuring*

A series of sovereign crises, in particular the Mexican financial crisis and the Asian financial crisis of the late 1990s, created the opportunity for the IIF to reestablish itself as the preeminent organization in the sovereign debt space. As noted earlier, private creditors started playing an increasingly prominent role in sovereign debt markets, which, in some ways, has made sovereign debt defaults more interesting. Private actors tend to be more determined to recover their investment, as exemplified by the pursuit of Argentinian assets by the so-called vulture funds through much of the 2000s. While this may be a profitable strategy for some investors, overall, it is not a very effective method of policing sovereigns because it will reduce recoveries for creditors as a group.

Creditors as a group would be better off if they engaged in talks aimed at a restructuring of the debt. In the corporate debt context, bankruptcy law helps reduce the transaction costs associated with such talks by providing a set of rules to be followed that aim to maximize the recovery for the creditor group. Unfortunately, there is no bankruptcy law or court for sovereigns. In the early 2000s, senior officials from the IMF proposed the SDRM as an effort to "create some of the features of a

[12] Newman and Posnner, *supra* note 3, at 786.

bankruptcy regime without creating a bankruptcy court,"[13] but the concept never came into fruition.

One of the main reasons for the project's failure was that the IIF, together with several other associations, came out strongly against it in a 2002 paper.[14] The paper identified several theoretical objections to the SDRM. Among other things, it challenged the assumption that there is an inherent collective action problem among private-sector creditors in a sovereign debt restructuring that precludes agreement. It also sought to undermine the analogy between domestic bankruptcy legislation and the SDRM by arguing that the SDRM would lack the necessary procedural checks and balances that render a domestic bankruptcy process fair and effective. However, the principal objection seemed to have stemmed from the private sector's concern that the SDRM will decrease the participation of public creditors in sovereign debt restructurings, erode the rights of private creditors, and increase the frequency of sovereign debt restructurings.[15]

While the proposal enjoyed considerable support from the official sector, it ultimately failed to establish the SDRM. Sean Hagan, the IMF's general counsel at the time, provides an account of the failure.[16] The most important reason for the failure is that the implementation of the SDRM would require an amendment to the IMF's Articles of Agreement. Under the Articles, a majority of three-fifths of the IMF's members holding 85 percent of the voting power was needed. Since the United States held 17.14 percent of the IMF's voting power, its participation was required. The United States ultimately declined to do so largely, as Hagan notes, due to steadfast opposition to the SDRM proposal by the major financial industry associations.

> Not only did such opposition make it much more difficult for the SDRM proposal to be approved in Congress, but there was clearly a reluctance within the U.S. government to forge ahead with such an important reform of the international financial system when a key stakeholder in that system – the private sector – was so resistant.[17]

[13] A. Krueger, first deputy managing director of the IMF, first articulated the proposal in a 2001 speech.

[14] EMCA, EMTA, IIF, IPMA, ISMA, SIA, BMA, *supra* note 4.

[15] The following passage from the letter speaks to that: "In some official quarters, the SDRM is also seen as key to limit the size of official financing packages in the future as well as an instrument to force burden sharing. However, it remains unclear how the presence of an SDRM would constrain political decisions in favor of or against official funding in any given case."

[16] S. Hagan, Designing a Legal Framework to Restructure Sovereign Debt (2005) 36 *Georgetown Journal of International Law* 299.

[17] As he further notes, opposition to the SDRM proposal by financial industry associations was, of course, also an important reason why a number of emerging market countries opposed the SDRM proposal. "The private sector consistently warned that the SDRM, if adopted, would adversely affect the volume and price of capital to these countries." Hagan, *supra* note 16, at 392.

Interestingly, Hagan notes that European and Asian financial institutions were less openly hostile to the SDRM proposal than their US counterparts.[18] Moreover, industry associations made up of investors that actually purchased and held sovereign debt (the "buy-side") were more willing to engage in discussions regarding the design of the SDRM proposal than those responsible for actually placing new bond issuances for emerging market sovereigns (the "sell-side").[19]

The private sector's opposition to the SDRM was also premised on the ongoing work on standard aimed at facilitating sovereign debt restructurings through voluntary means. Those standards took two primary forms: collective action clauses (CAC) in sovereign debt documentation and a code of conduct known as the Principles for Stable Capital Flows and Fair Debt Restructuring.

CACs were a response to a design feature of sovereign debt contracts, which historically required all creditors to agree to a restructuring giving rise to the problem of holdouts or investors unwilling to agree to the terms of the restructuring. Since the mid-1990s, the official sector has encouraged CACs in international sovereign bonds, but that has not changed the market practice much.[20] Data quoted in a 2002 IMF report indicated that the vast majority of international sovereign bonds outstanding in that year did not contain CACs.[21] The two main reasons identified in the report for the resistance in adoption are short-run costs associated with introducing any change in documentation (inertia) and concerns that issuers might face a permanent increase in borrowing costs if they were to introduce such provisions. The report notes that there is no evidence that the use of CACs would systematically raise borrowing costs. Concerning the first issue, short-run costs, and inertia, it notes that these problems could largely be overcome through the broad adoption of CACs. While it was apparent the IMF could play an important role in promoting such adoption, for example, by using clauses as a condition for access to Fund resources and/or special facilities, there was the issue of which clauses to promote exactly?

[18] Ibid.

[19] Ibid.

[20] IMF, The Design and Effectiveness of Collective Action Clauses (June 6, 2002).

[21] Crucially, the report noted, even if new issues of bonds include CACs, it will take a significant amount of time for the majority of international sovereign bonds to contain such provisions because the speed with which non-collective action clauses bonds will be replaced is a function of their maturity profile and assumptions about the growth in net new issuance of bonds. "Assuming that all bond issuance from now on will include collective action clauses and that net new bond issuance grows at a rate of roughly 3 percent per annum, approximately 80 percent of the bond stock would contain collective action clauses by 2010 and approximately 90 percent by 2019." As more recent data from the IMF shows, from end of September 2017 to the end of October 2018, only 8 percent of issuances did not include enhanced CACs. IMF, Fourth Progress Report on Inclusion of Enhanced Contractual Provisions in International Bond Contracts (March 2019).

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For a long time, the IMF has monitored the use of CACs in the market. In one of the first documents surveying their use, it classified them into two types: "majority restructuring" provisions, which enable a qualified majority of bondholders of an issuance to bind all holders of that issuance to the financial terms of a restructuring, either before or after default, and "majority enforcement" provisions, which enable a qualified majority of bondholders to limit the ability of a minority of creditors to enforce their rights following a default, thereby giving the debtors and the qualified majority of creditors the opportunity to agree upon a restructuring.[22] There was a large variation of provision within these two types, particularly concerning voting thresholds.

The lack of uniformity in the drafting of CACs presented a unique opportunity for the IIF to engage in standard-setting – an activity it has previously shied away from. Other trade associations benefited from the first-mover advantage in this space. In the late 1990s, the EMCA proposed a model majority restructuring provision that would allow for a restructuring of key terms based on an affirmative vote of 95 percent of the bondholders. Still, that was viewed by the IMF as too high of a threshold, effectively defeating the purpose of the majority restructuring provision. The skeptical reception of the 95 percent threshold led another trade association, the ICMA, specifically its predecessor, the IPMA, which later, together with the ISMA, merged into ICMA to develop the 2003 Model Collective Action Clauses for Sovereign Bonds (under New York Law). The IIF, together with several other associations, endorse the model developed by ICMA, which provided for an 85 percent threshold.

In August 2014, ICMA published the latest sovereign debt contract reforms package, including new and updated CACs, a revised pari passu clause, and a model creditor engagement clause. The updated CACs – which include a menu of voting procedures including two different options for aggregation of votes across series to secure creditor agreement for modification of payment terms – was widely welcomed as a "means of facilitating collective action and avoiding disruption to sovereign debt restructurings that can arise from holdout litigation." In 2015, the IIF – also a collaborator in the drafting process – endorsed the full package of the ICMA contract reforms.

The second prong of the standard-setting activity that the IIF was involved in concerned developing a code of conduct for actors participating in sovereign debt restructurings – what has later become known as the Principles for Stable Capital Flows and Fair Debt Restructuring. The publication of the Principles in 2004 followed from an early 2000s initiative of Jean-Claude Trichet (at the time, the governor of the Banque de France), who launched proposals for a Code of Good Conduct governing creditors and debtor states' behavior. The G20 relegated the development of the Code to a working group led by the Banque de France and the

[22] IMF, *supra* note 20.

IIF. The prominent role played by the IIF in the process can be linked to its increasing advocacy activities described earlier. By the early 2000s, the IIF had already established itself as the principal interlocutor for regulators and policymakers and managed to persuade several prominent figures from the financial industry to become members of its various committees. This included Jacques de Larosière, also a former governor of the Banque de France and in the early 2000, co-chairman of the IIF's Special Committee and advisor to the chairman of BNP Paribas Group. The Principles were endorsed by the G20 in 2004.[23]

The Principles focused on four areas: transparency and timely flow of information, close debtor-creditor dialogue and cooperation to avoid restructuring, good faith actions, and fair treatment. Before 2010, the Principles applied only to sovereign issuers in emerging markets. However, their applicability has since been broadened to encompass all sovereign issuers (voluntarily) and cases of debt restructurings by non-sovereign entities in which the state plays a major role in influencing the legal and other critical parameters of debt restructurings.

As the IIF notes,

> the Principles promote early crisis containment through information disclosure, debtor-creditor consultations, and course correction before problems become unmanageable. They also support creditor actions that can help to minimize market contagion. In cases where the debtor can no longer fulfill its payment obligations, the Principles outline a process for market-based restructuring based on negotiations between the borrowing country and its creditors that involve shared information, are conducted in good faith and seek to achieve a fair outcome for all parties. Such a process maximizes the likelihood that market access will be restored as soon as possible under sustainable macroeconomic conditions.[24]

Adherence to the Principles is voluntary – accordingly, their effective implementation requires acceptance and adherence by both debtors and creditors. The Group of Trustees of the Principles, with the support of the Principles Consultative Group, encourages and monitors the implementation of the Principles. While these groups have no statutory authority, they have earned de facto acceptance by sovereign debtors, their creditors, and the international policy community due mainly to the reputation and stature of their members, who collectively have decades of experience in international policy and capital markets. The IIF serves as secretariat to both groups. What that means in practice is that the IIF, building on its surveillance practice, collects information about individual debtors, asks for input members of the Principles Consultative Group, and produces an (annual) report on the progress in the implementation of the Principles.[25]

[23] TBC.
[24] IIF, Principles For Stable Capital Flows and Fair Debt Restructuring and 2012 Addendum, at 2.
[25] Interview, member of the Principles Consultative Group, April 2021.

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The development and continued relevance of the Principles, given the cyclical nature of sovereign debt crises, allowed the IIF to expand its influence through the strategy of standard-setting. The Principles are now viewed as an indispensable feature of the sovereign debt market. The IIF, through its role as a secretariat to the Group of Trustees and the Principles Consultative Group and beyond it, is an organization indispensable to their functioning. More recently, the IIF has taken further initiatives aimed at enhancing its role even further. For example, in 2019, the IIF developed the Voluntary Principles for Debt Transparency. These new Principles build on the key guidelines of the Principles for Stable Capital Flows and Fair Debt Restructuring, and their implementation is also monitored by the Principles Consultative Group as well as the IIF itself.

4.3 THE CONTRACTUAL FRAMEWORK FOR SOVEREIGN DEBT RESTRUCTURING IN THE COVID-19 PANDEMIC

In early 2020, many countries in the world imposed strict lockdowns to control the outbreak of the pandemic, thereby effectively freezing economic activity for months. While the economic hardship these measures would entail was apparent, those measures were believed to be necessary to control the pandemic. Economic policymakers were immediately confronted with the question of how to manage the economic fallout. Domestic policymakers needed to identify resources that would enable them to stimulate aggregate demand through fiscal policies. It was clear that such stimulus requirements would make it more difficult for those countries to service their international debt obligations and necessitate the incurrence of new debt. In other words, it was clear that countries would require cooperation from their creditors.

What was the reaction of the creditor community to the apparent need faced by countries? On March 25, 2020, the president of the World Bank Group and the managing director of the IMF released a Joint Statement calling on official bilateral creditors to suspend debt payments from the member countries of the International Development Association to allow those countries to devote their liquidity to tackle challenges posed by the coronavirus outbreak.[26] Private creditors (and other international creditors, including sovereign wealth funds) should commit, upon specific request by the sovereign debtor, to forbear payment default for the poorest and most vulnerable countries significantly affected by COVID-19 and related economic turbulence for a specified time (e.g., for six months or to the end of 2020), without waiving the payment obligation.

In response to the COVID-19 "call to action" from the World Bank and the IMF, the G20 finance ministers and Central Bank governors announced the DSSI on

[26] Joint Statement World Bank Group and IMF Call to Action on Debt of IDA Countries (March 25, 2020).

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April 15, 2020, supporting a net present value-neutral, time-bound suspension of principal and interest payments for eligible countries that make a formal request for debt relief from their official bilateral creditors and encouraging private creditors to participate on comparable terms.[27] The communique called for private creditors to work through the IIF.[28]

The IIF initially agreed with the approach. In a letter addressed to the IMF, World Bank, OECD, and Paris Club, it noted that private creditors (and other international creditors including sovereign wealth funds) should commit, upon specific request by the sovereign debtor, to forbear payment default for the poorest and most vulnerable countries significantly affected by COVID-19 and related economic turbulence for a specified time (e.g., for six months or to the end of 2020), without waiving the payment obligation.[29]

However, in a subsequent letter, dated May 4, 2020, the IIF provided an updated and stressed that participation should be wholly voluntary.[30] In effect, the private creditors declined to participate in the DSSI, other than on a voluntary, case-by-case basis.

The IIF's outreach in the case of the DSSI has been primarily via two IIF policy working groups.[31] The IIF has, among other things, surveyed its members about the status of requests made by DSSI-eligible countries to private creditors concerning debt suspension. As reported by the Principles Consultative Group, a June 2020 survey revealed no such requests had been made.[32] By September, four private creditors have been approached by countries eligible for the DSSI requesting forbearance on comparable terms to official creditors.[33]

While the limited requests from debtors arguably explain the limited involvement of creditors, we should bear in mind that outcome is at least partly the result of the private creditors' refusal to participate in the DSSI other than on a voluntary, case-by-case basis. It was that decision that created the structural conditions for private creditor free-riding. As of August 2020, forty-three countries out of seventy-three

[27] G20 Finance Ministers and Central Bank Governors Meeting, Communiqué (April 15, 2020).

[28] "We call on private creditors, working through the Institute of International Finance, to participate in the initiative on comparable terms." G20, *supra* note 27, at 1.

[29] Institute for International Finance, IIF Letter Debt LICs (April 9, 2020).

[30] Institute for International Finance, Letter to IMF, World Bank and Paris Club on a Potential Approach to Voluntary Private Sector Participation in the DSSI (May 4, 2020).

[31] "Most of these firms are IIF members; many other private creditors and lenders have also contacted us in recent weeks to learn more about the DSSI. Based on these conversations, we believe there is a deep appreciation for the challenges facing these most vulnerable countries and strong interest in finding ways to support them and the proposed debt service suspension." Ibid.

[32] Principles Consultative Group, Principles for Stable Capital Flows and Fair Debt Restructuring: Report on Implementation (October 2020), at 24.

[33] Ibid.

eligible have made use of the DSSI; these countries, mainly from sub-Saharan Africa, will benefit from postponed debt payments of an estimated US$5 billion.[34]

Nevertheless, there is the concern that the primary purpose of the debt relief offered by public creditors, whether by way of the DSSI or by other means, will be to pay private creditors. David Malpass, the president of the World Bank, had expressed that concern in a recent interview when he said that "there is a risk of free-riding, where private investors get paid in full, in part from the savings countries are getting from their official creditors."[35] As Bolton et al. note,

> if left entirely to their preferences, commercial lenders will behave in a commercially predictable manner even if this means, as it probably will with the DSSI, being tagged with the mildly opprobrious title of free-rider. Some of the emergency financial assistance being provided to the poorest countries by multilateral financial institutions, and some of the debt relief resulting from debt payment suspensions granted by bilateral creditors, will end up being used by the debtor countries to service their commercial obligations. To this extent, the private sector will free ride on the public sector.[36]

What is the scale of private creditor free-riding? As reported by the European Network for Debt and Development, a nonprofit organization, between May and December 2020, the original duration of the DSSI suspension, the sixty-eight eligible countries for which data is available are paying around $10.22 billion to private creditors.[37] The forty-six countries that are receiving debt service suspension are paying $6.94 billion to private creditors. This is $1.64 billion more than what they are receiving from bilateral lenders as debt suspension.

4.4 STANDARD-SETTING AND ORGANIZATIONAL RESILIENCE

The IIF was not the only and certainly was not the first trade association to contribute to the standard-setting process in the realm of sovereign debt. The process has been initiated by a group of trade associations, sometimes referred to as the "Gang of Six," with ICMA taking the helm of that process. ICMA had considerable experience in drafting model clauses and contracts for capital market transactions. The IIF never sought to compete on that front – to the contrary. It engaged in cooperation with ICMA. Still, it made efforts to reorient its activities and governance toward that process by putting forward the proposal that its Global Policy Initiative Department will act as a secretariat to the Group of Trustees and the Principles Consultative

34 International Monetary Fund, The World Bank, Implementation and Extension of the Debt Service Suspension Initiative (September 28, 2020).

35 D. Malpass, World Bank: Covid-19 Pushes Poorer Nations: From Recession to Depression, *The Guardian*, August 19, 2020.

36 P. Bolton et al., Sovereign Debt Standstills: An Update, VoxEU.org (blog), May 28, 2020.

37 European Network on Debt and Development, The G20 Debt Service Suspension Initiative: Draining out the Titanic with a bucket? (October 2020).

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Group. In 2001, it established the Committee on Sovereign Risk Management, which has played an important role in the establishment of the Principles for Stable Capital Flows and Fair Debt Restructuring and the ongoing development of the voluntary contractual approach to sovereign debt restructuring.

The emerging framework provided an opportunity to strengthen the position of the IIF in the sovereign debt space. The IIF's management skillfully capitalized on this opportunity. The IIF's management did not only reorient the organization toward transnational policy initiatives, such as the Basel Accords, but also created and actively fostered the development of standards, such as the Principles for Stable Capital Flows and Fair Debt Restructuring. Standard-setting can thus be viewed as a strategy of organizational resilience – one that builds on and complements the strategies identified by Newman and Posner. In other words, standards are valuable not only to their users but also to the organizations that develop and promote them. It may be simplistic to only view the economic function of standards from the standpoint of its use cases. We should also recognize and examine how the setting of standards contributes to the empowerment of private standard-setting organizations and their advocacy agenda.

4.5 CONCLUSIONS

Trade associations need to retain existing members and acquire new ones to continue to exist. On that count, the IIF has done a remarkable job, which ensured its continued existence and relevance. The goal of this chapter was to cast light on the strategies adopted by the IIF to achieve that goal. Beyond the maintenance of its original function of monitoring sovereign borrowers, the existing literature has identified three strategies of organizational resilience adopted by the IIF during a period of its relative decline in the early 1990s: first, identifying new constituencies; second, reorienting toward transnational policy advocacy; third, adapting its governance accordingly.

In this chapter, I have argued that in the wake of new regulatory developments in the sovereign debt space, the IIF has successfully adopted a fourth strategy of organizational resilience: standard-setting. Specifically, the IIF has reoriented itself toward the endorsement of a contractual approach to sovereign debt restructurings. Furthermore, it has adapted its governance to reflect this new goal. Finally, it led standard-setting activities that helped entrench it as the leading actor in this space. The IIF's role in shaping the private sector's response to the looming sovereign debt crisis induced by the COVID-19 pandemic is an excellent example of that.

What can we make out of the preceding analysis? The key takeaway is that financial trade associations create structural conditions for their relevance through their standard-setting activities. The process through which they create the conditions and maintain their relevance is a vital source of leverage that public policymakers should seek to exploit. US financial institutions may not have the same interests as European or Asian institutions; the buy-side does not have the same interest as the sell-side. Policymakers should seek to exploit these heterogeneous preferences to promote their goals. The IMF's attempt to create the SDRM was a good attempt to at doing just that. Despite its failure, that attempt could serve as an inspiration for how personality and skilled diplomacy can seek to orient private collective action toward the provision of global public goods rather than club goods.