Re: Comments on Proposed Amendments to S.5623/A.5290 ("Purchase of claims by corporations or collection agencies")

The Securities Industry Financial Markets Association and its Asset Management Group (SIFMA and SIFMA AMG)[1] write in response to proposed amendments to a Champerty bill (S.5623 / A.5290) which were released for comment by Senator Liz Krueger and Assemblymember Jessica González-Rojas on May 20, 2024.

SIFMA and SIFMA AMG represent a wide spectrum of members who operate in the capital markets, including banks, broker-dealers, and asset managers. Banks lend and underwrite securities offerings, broker-dealers facilitate trading, and asset managers invest on behalf of their underlying clients. Many have decades of history, and some have institutional lineage dating back to the early days of the existence of the State of New York and the United States of America. They have worked with sovereign issuers across the globe through periods of growth and distress, periods of prosperity and default, and periods of geopolitical stability and instability.

Each provides a different function, but all are united in the common cause of helping those in need of capital to find those with available capital. Each borrower and lender have unique needs and objectives, but the ability to enable ongoing financing and investment is what allows countries, corporations, and individuals to pursue their financial objectives. Meeting financial objectives allows each to meet their personal, organizational, national, and international goals.

I. Executive Summary

As a threshold matter, we note the brief timeframe provided for comments in response to the proposed changes. A handful of days spanning a holiday weekend does not align with the gravity and complexity of the proposed bill and related amendments. Such changes involving a trillion-dollar market deserve methodical analysis and consideration. We strongly urge that no bill be advanced during this legislative session, both on the merits and on the lack of sufficient time for deliberation.

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[1] SIFMA is the leading trade association for broker-dealers, investment banks, and asset managers operating in the U.S. and global capital markets. On behalf of our members, we advocate for legislation, regulation, and business policy affecting retail and institutional investors, equity and fixed income markets, and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency.

SIFMA's Asset Management Group ("SIFMA AMG") brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms that manage more than 50% of global assets under management. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds.

The proposed bill and amendments currently under consideration will harm more than help. Given the abbreviated comment period, we raise five primary concerns at this time:

- Legislative actions that intervene in commercial contract matters on behalf of or against a particular party undermine confidence in the market.
- Legislating different and adverse terms for some investors based on investor intent inferred from prior conduct is contrary to equal protection and would create significant practical issues for all market participants and sovereign debt issuers.
- Creating disincentives for lenders or those who buy debt issued by sovereigns is counterproductive. Increasing the risk of an uncertain future with arbitrary or unpredictable contract resolution is bad for both borrower and lender, particularly for the most vulnerable sovereign issuers.
- Asset managers who invest in sovereign debt typically act as agent, not principal. They invest on behalf of others, including mutual fund shareholders and pension and retirement plan beneficiaries, who will bear the cost of market distortions and uncertainty created by the bill.
- Multi-national sovereign debt resolution and rescue plans are complex and interconnected projects. Distressed countries benefit from broader public policy driven initiatives rather than one-off attempts to "fix" just one element.

The State of New York should not assume that borrowers can only select New York for their choice of law. Its position in the current market exists precisely because of the absence of proposals such as this bill. Capital is fungible and portable and there are many states and countries that would welcome growing their presence as a home for sovereign debt issuance. New York became a choice of law partially because of the concentrated presence of financial services and legal professionals. Especially in a post-COVID environment where many other states have far outpaced New York in financial services job growth, New York cannot assume that it will be the only choice.

II. Legislative Actions that Intervene in Commercial Contract Matters on Behalf of or Against a Particular Party Undermines Confidence in the Market.

New York has been a preferred place for capital markets not just because buyers and sellers or borrowers and lenders can find each other in one place. They also rely on the legal framework that has evolved to support capital markets activity and rely on that framework being stable and predictable.

The founding of the New York Stock Exchange in 1792 under the branches of a buttonwood tree involved two dozen traders, stockbrokers and merchants who mutually agreed to a set of principles to make trading easier. The power in that agreement was not the economic terms of a specific trade but rather knowing they had agreed to the same principles and knew those principles would continue to be honored. The need for an agreement came from a financial credit crisis earlier in the year and helped re-establish confidence for those involved in the market.

New York State has been a preferred place for issuance and trading of securities in the capital markets because it offers a stable framework of state laws and a knowledgeable judiciary that has developed and grown as the markets have developed and grown. Borrowers and lenders know what to expect. There will always be questions of first impression or disputes between parties that see the world from different perspectives, but there has been little concern that the rules will change or that the process will produce arbitrary determinations. There is confidence in the market.

The proposed Champerty bill and amendments under consideration would be a sharp departure from this precedent and undermine New York's status as a jurisdiction in which contracts are recognized as sacrosanct. Intervening on behalf of specific parties with a goal of reducing or cancelling debt challenges the very foundational notions of a process designed specifically to ensure fair treatment of all involved. In the name of attempting to help one party (a sovereign with difficulty servicing its outstanding debt), the proposal would abandon principles of equal treatment based on investing and negotiating posture. The proposal would also perversely make it more difficult for emerging market sovereign issuers to raise capital at reasonable rates regardless of whether they are currently in distress.

When the rules are unstable and designed to help one party, those who are not disfavored today know they may become disfavored tomorrow depending on shifts of political winds. Such implications undermine confidence in the market.

III. Legislating Different and Adverse Contract Terms for Some Investors Based on Investor Intent is Contrary to Equal Protection and Would Create Significant Practical Issues for All Parties.

A. Contract Disputes are Inherently Adverse

Our members do not invest or work with sovereign issues hoping for a workout scenario. A default is a lengthy workout process which adds cost, complexity, and prevents ongoing investment. When any issuer is unable to meet its debt obligations – whether it has an inability to meet periodic coupon interest payments or inability to repay maturities when due – the party holding the bond has not received the expected benefit from the agreed terms. This creates a situation where two parties have different perspectives and interests.

Laws and courtrooms allow peaceful resolution without resorting to physical combat or colonial-era duels. Litigation is the mechanism that the United States uses to resolve contract differences. Singling out certain investors that we don't like for lesser contract rights because we disapprove of their motivations or restricting legal access to the courts for otherwise equally situated creditors applies economic penalties and barriers for the privilege of seeking to enforce contract rights. Such an approach runs directly contrary to foundational and constitutional equal rights protections and invites significant uncertainty into a process that benefits from stability and predictability. Other debt resolution structures such as bankruptcy law work because the court is a neutral broker, not because the court is working to evaluate claims based on perceived investor motivations and adjust the outcome accordingly.

Regardless of why a bond was purchased, each bond holder has a legal contract with the issuer in the form of the security that was issued. Each bond holder expects that the terms of the contract and State law will treat them fairly and equally with other bond holders. Each expects that in a resolution scenario, a process overseen by an independent court will treat creditors fairly.

It would be an extraordinary result if two different parties that hold the exact same bonds issued by the exact same issuer could experience a dramatically different result in a restructuring because a state law mandated that one was disfavored. This would materially distort markets and create an unlevel playing field for investors.

If not for the ability to enforce contracts, the issuer's incentive to set aside their obligations increases. Issuers with scarce funds may decide to service or repay some debts rather than others depending on their sense of which bondholders will seek to enforce the contract. They may decide not to service the debt at all given other competing local priorities. Investors need the right and ability to litigate to enforce contract terms, even if they choose not to use it. Investors that do not choose to litigate benefit from the willingness of some to litigate when warranted.

When a contract resolution is inherently adverse, seeking to punish certain parties for seeking to enforce the contract terms is bad public policy. It also sets a disturbing precedent that the State of New York could tilt the scales in favor or against any party or class of parties in any contract dispute.

B. The Proposed Legislation Creates Practical Issues that Would Frustrate the Bill's Objectives

Stability and predictability are hallmarks of a mature contract resolution framework. The proposed bill ostensibly seeks to facilitate a favorable resolution of sovereign debt matters by introducing a series of triggers and findings that add complexity and uncertainty. Instead of making the process more streamlined and efficient, however, the proposed bill would likely have the opposite effect.

For example, under the proposed bill, investor intent would determine contract rights. That presents a material decision point in any legal process. Such an assessment hinges on whether a bondholder's actions and claims were deemed to be made in good faith. Any asset manager who has invested in emerging market debt on behalf of their clients has an incentive to avoid being so designated given the severe implications, but they do not know when they make an investment whether and how their investing history will be interpreted by a court if a debt resolution dispute arises later. Inquiries into intent will necessitate costly and expansive legal discovery for financial institutions and parties with whom they communicate and interact about their investments.

Different judges may have different perspectives on what constitutes "participating in good faith alongside other creditors in consensual resolutions" or whether "claims were acquired against obligors at a significant discount from face value" or whether a creditor "resorted to legal enforcement of the acquired claims." The determination might vary depending on the case of a specific sovereign issuer and specific debt at issue. The factors are not only opaque but fail to consider prior "good faith" conduct of the investor or prior conduct of the borrower that may have hindered productive resolutions. In criminal trials, past bad acts are not admissible as proof of guilt. In debt restructuring matters, prior legal acts should not be held against a bondholder. The price a bondholder paid for a bond should have nothing to do with their legal contract rights or ability to litigate to enforce the contract.

At the outset of a restructuring process, a bondholder wouldn't know where they stand so they'd need to guess and account for that uncertainty. The uncertainty would persist until a determination is rendered and they would have no comfort when that day might come.

If a judge finds a bondholder is uncooperative, the asset manager will inevitably challenge the determination with further litigation. They have no choice because such a finding will determine the outcome of that matter and influence determinations in the future. Financial services companies that work with emerging market issuers and investors have a material amount of business capital and staff dedicated to this business line.

Anyone in the business for a reasonable amount of time is likely to run into a restructuring scenario. Carrying a scarlet letter would be a serious impediment. The proposed bill shifts significant benefits to sovereign issuers by design. The magnitude of those benefits – coming at the expense of bondholders – increases the stakes and would force ongoing fights and prolong litigation.

Conversely, the sovereign issuer has every incentive to advocate that bondholders are uncooperative, given the potential economic benefits they stand to realize. Perversely, the sovereign issuer has an incentive to become less cooperative themselves. In an adverse proceeding, any substantive position taken by an opposing party is "uncooperative" unless and until both parties reach mutual agreement – which is how the current process works.

Nothing in the proposal has suggested that judges lack the authority to address illegal conduct or legal practices at odds with professional ethics standards. If "good faith" in restructurings becomes that type of an issue, then it warrants treatment through other means.

The proposed amendments to S.5623 / A.5290 also rely on a finding by the International Monetary Fund (IMF) that the debt is "unsustainable." The IMF makes no such designations or formal determinations. Instead, it characterizes debt that is conditional on specific sets of policies. This produces yet another point of contention. An issuer will see "unsustainable" as self-evident, but the potential benefits of the bill would give them a powerful incentive to take that position. Bondholders might not see it that way. As a matter of legislative drafting design, no New York State law should be dependent on what IMF policies are or are not because IMF policies and approaches and uses of terminology could change at any time. Like the determination of investor good faith, introducing this nebulous concept would result in more legal wrangling, cost, and prolong a restructuring process.

IV. Creating Disincentives for Bondholders of Debt Issued by Sovereigns is Counterproductive.

Borrowing is an exercise in utilizing money from others and determining how much that use will cost and when the money will be repaid. The capital markets allow borrowers to seek financing by issuing debt instruments. Armed with market knowledge, they offer terms. The terms need to be sufficiently compelling to convince those with capital to make their capital available to the borrower. If the terms are not compelling, the lender will go elsewhere to invest its capital.

Lending through investing is an exercise of making capital available and seeking compensation for the use of the capital. In fixed income terms, the expectation is that the principal will be repaid at maturity and periodic interest payments will be made on a scheduled and timely basis in the interim. Investors assess the potential risks and rewards of various investment options and continually seek return. All things being equal, the same returns with less risk are better than those with more risk. Increased risk usually requires increased incentive to allocate capital which comes in the form of better economic terms for the investor.

The issuer and bondholder both rely on a stable legal framework. Borrowers rely on the laws to require the bondholders to produce the promised financing. Bondholders rely on the laws to enforce the terms and covenants of the bond issue. Banks and underwriters likewise decide whether they can do business with particular countries. They take legal and business risk when they arrange financing, and those risks are factored into the borrowing rates borne by the borrower. The economic terms are negotiable, but the resolution of their legal matters requires an independent framework -- state contract law.

How does an asset manager make assessments at the time of investment about how state law would play out in the event of a restructuring? In the case of large entities with multiple groups, subsidiaries and/or affiliates, the proposed bill would create a risk for all based on the conduct of one. The risk of being deemed to be acting in bad faith and having a contract nullified or abrogated undoubtedly makes the bond a riskier investment.

In response, an asset manager would avoid such issues and/or look for higher interest rates to compensate. They have a greater incentive to sell holdings to avoid a default and the uncertainty of a restructuring process, further weakening the financial position of the issuer.

Asset managers already consider a wide variety of factors when they invest in sovereign debt, including the probability of default, currency risk, economic health of the country, liquidity, and ability to trade instruments and determine pricing, and local political risk. The proposed bill would introduce additional and significant risks to the viability of the contract.

Sovereign issuers could insist that their local law controls any disputes over the terms of the bonds. Instead, they have often chosen to come to the United States and select New York as the choice of law. Stability and predictability of legal venue lowers their cost of capital. Otherwise, investors would assess the risks to be much higher and the sovereign would either need to pay more to attract investment or risk not raising the desired funds.

Arguably, the proposed bill would impact the weakest sovereign issuers the most. The proposed bill would, in effect, push asset managers to “safety” and away from vulnerable countries and regions that need the support of international capital markets the most. These vulnerable countries have the fewest options of other venues and markets, the least amount of time to outwait a lengthy process, and investors have many alternatives elsewhere. Even a “win” in one scenario would damage that issuer’s credibility and creditworthiness in the market in the future. It would be a short-term victory and likely lead to higher borrowing costs in the long run or further litigation – both of which would harm countries in need of development capital and ongoing financing.

Anything that raises risk for the investor makes the cost for the borrower higher. Anything that impedes the flow of capital makes it more difficult for the sovereign issuer to raise the funds they need. Anything that introduces uncertainty threatens to undermine the contract foundations that underpin public financing. Public policy should be working to encourage and facilitate investment rather than deter it.

V. Asset Managers are Agents, not Principals.

By law, asset managers are fiduciaries, which means they are compelled to act in the interest of their clients. This principle was established by the US Supreme Court in 1963 through the SEC v. Capital Gains Research case. Our asset management members invest on behalf of others. Their underlying clients and investors placed their funds with the asset manager with the belief that the asset manager would work on their behalf to generate returns. It isn't the asset manager's money.

Investment losses are borne by clients and investors – not the hedge funds or asset management firms. Debt reduction (or cancellation) in favor of a sovereign issuer comes at the expense of the bondholder. The "bondholder" is the underlying client, not the asset manager. If there are reductions in the value of sovereign debt holdings, the people who bear that cost will not the be asset manager but rather the foundation or endowment, individual client, mutual fund investor, or a pension plan beneficiary. Those clients could be other sovereign investors as well.

Our asset management members are fiduciaries, investing on behalf of their clients. There should be no structural barriers to any party to access to a fair legal system to enforce the contract rights on behalf of their clients.

In a statement on August 23, 2023, in support of new rules being adopted by the US Securities and Exchange Commission, Chair Gary Gensler said: "Private funds and their advisers play a significant role for investors and issuers. They play an important role in nearly every sector of the capital markets. On one side are the funds' investors, such as retirement plans or endowments. Standing behind those entities are millions of investors like municipal workers, teachers, firefighters, professors, students, and more. On the other side are issuers raising capital from private funds, ranging from startups to late-stage companies." Chair Gensler recognized the vital role that private funds play in the capital markets and recognized that investors in private funds are millions of individual investors.

While it may be tempting to malign certain types of investors because they act legally but not as we might wish, it is not ultimately productive for either borrower or bondholder. Even asset managers that are "conventional and generally cooperative" benefit from the presence of others willing to assume risk. Asset managers looking to avoid defaults and a long restructuring process may sell to meet the expectations of their clients. Brokers and hedge funds can be buyers when it might be difficult otherwise to find buyers. A hedge fund or specialist broker might be among the few willing to take a risk that default can be avoided, particularly because their investment time horizon may be longer than that of another investor. Having investors with varying time horizons, some longer term investors and others shorter term, keeps the sovereign debt market healthier than it would be otherwise. There are a wide range of investment opportunities, investors, and risk appetites and there will always be different assessments of risk and reward. Healthy capital markets thrive on this feature. Good public policy doesn't attempt to distinguish between investors we like and investors we don't like and pick winners and losers accordingly.

VI. Multi-national Sovereign Debt Resolution and Rescue Plans are Complex and Interconnected Projects.

Sovereign debt restructurings are typically not small projects. The issues are also much broader than the individual securities involved. Economic health and development, foreign currency and exchange rates, inflation, imports and exports, tax and spending policies, and more are intertwined. Bodies like the IMF are specifically organized to operate as a quasi-governmental body given the broader public policy and public interests involved. The solutions are complex, interconnected, and long-term in nature.

An IMF staff paper published in December 2021 on sovereign debt restructuring concluded that: "A strategy that engages creditors constructively, and as transparently as possible, that relies on market-based incentives, and that presents the exchange as part of a consistent macroeconomic plan typically works best."

As debt service is one part of the bigger picture, the better approach is to continue deferring to those with the mandate to manage such projects. Attempting to unilaterally "fix" one aspect would inject an additional unknown factor, threaten to upend the legal landscape for borrowers and lenders, and threaten the sources of capital available for development.

The IMF has warned that the proposals from the New York State legislature regarding sovereign debt would introduce significant uncertainty and prolong and complicate sovereign debt restructurings. This additional uncertainty will likely result in higher financing costs for issuers not yet in distress and those in the greatest need for relief, contradicting the goals of the proposed bill.

By raising barriers for private investment, the burden shifts to public financing. There may be a broader discussion to be had about the proper role of government financing and socializing losses, but the multi trillion-dollar investments made into emerging market sovereign bonds currently rely heavily on private funding.

We sincerely appreciate your willingness to consider our concerns and thank you for your time and consideration. If you have any questions, please contact SIFMA's New York counsel, Bob Reid, of Reid McNally & Savage at (518) 465-7330 or SIFMA's Marin Gibson at (212) 313-1317 or mgibson@sifma.org.