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From Argentina to Greece: Crisis in the Global Architecture of Orderly Sovereign Debt Restructurings¹

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- The [recent court rulings in New York](#) on a dispute between Argentina and a holdout creditor have very serious consequences that go far beyond Argentina. They have potential implications for the restructuring of official and private claims on Greece and for the entire global architecture of orderly sovereign debt restructurings, as pragmatically developed over the past decade. The status quo is at risk given the radical new judicial interpretation of the *pari passu* clause as implying that a sovereign cannot pay creditors that have accepted an exchange offer unless holdouts from the exchange offer are paid their original claims in full.
- This new interpretation allows holdouts to effectively seize an asset that is equivalent to the payments that a sovereign makes to other creditors that have accepted the exchange offer. The ruling has thus created a situation where there is a fight not only between the sovereign and holdouts, but also between creditors that accepted the exchange offer and those that held out.
- This mess matters for Argentina because the legal actions of a determined holdout are threatening the payments to be made to those that accepted the exchange offer; the country may have to default again on bond-exchange creditors or re-route those payments to its domestic jurisdiction if it refuses to pay the holdouts. It also matters for Greece as the 2012 debt-exchange offer exchanged old bonds that were issued in the Greek legal jurisdiction to new bonds that are subject to English law, which are harder to restructure. It is true that the English courts have not yet ruled on how to interpret *pari passu* but, if the precedent of the New York court were to become a global norm, the consequences for Greece (should it need to restructure its claims held by private creditors again, which is likely) and other orderly debt restructurings in DMs and EMs alike would be serious.
- In particular, there is now a serious risk that orderly debt restructurings that are beneficial to both the sovereign debtor and its creditors may unravel and fail as creditors otherwise willing to accept an exchange offer may hold out if they fear that their exchanged bonds could be seized by other holdouts.
- The official sector—the IMF, the U.S. Treasury and other DM governments—is asleep at the wheel while a single strong-willed judge in New York threatens to up-end the existing regime for restructuring sovereign debt. The official sector's relationship with Argentina has been antagonistic for over a decade, but what is being decided in U.S. courts is relevant not just for a country that some perceive as a "rogue state." Unless the U.S. government starts to pay attention, the risk is the whole architecture for the orderly restructuring of sovereign debts will be destroyed, with serious consequences for global financial stability.

¹ I thank Anna Gelpern and Brett House for comments and feedback on an earlier draft of this paper.

The [recent court rulings in New York](#) on a dispute between Argentina and a holdout creditor have very serious consequences that go far beyond the Argentine case. They have potential implications for the future restructuring of official and private claims on Greece and for the global architecture of orderly sovereign debt restructurings (such as it is), which has developed since the late 1990s—more through an evolution of practice and experience (along with experimentation with old and new tools such as exchange offers and collective action clauses—CACs) than a fully thought-out process. This orderly regime is now at serious risk of collapse given the U.S. courts' radical new interpretation of the *pari passu* clause (as well as other clauses) and the precedent that this interpretation—if upheld by the courts to become a precedent—could have for future debt restructurings of insolvent sovereigns.

Argentina and Greece: Similarities and Differences

On the surface, Greece and Argentina have very little in common: One is a European developed market economy (or at least is perceived as such, allowing the markets to overlook its [history as a serial defaulter](#)) that is part of the eurozone (EZ); the other is an EM commodity exporter. But their similarities are greater than the differences: Both have been trapped in exchange rate regimes that have not allowed the use of nominal currency flexibility to deal with a loss of external competitiveness (Greece is a member of a monetary union, while Argentina was stuck until 2001 in a currency board peg to the U.S. dollar). Both lost external competitiveness—as a result of domestic and external factors—and started to run current account deficits that became unsustainable and led to a sudden stop of foreign capital to finance them. Both had a history of weak state institutions (patronage and partial capture by vested interests). Both ran fiscal deficits that led to the building up of public debt, which became unsustainable when a deep recession followed the loss of external competitiveness and the interest rates on their public and foreign debt sharply increased (following the sudden stop of capital). Both were forced to coercively restructure their public debt: In the case of Argentina, the exchange offers in 2005 and 2010 that followed a formal default on foreign creditors in 2001; in the case of Greece, the legislative insertion of punitive retroactive language weakening bondholder rights preceded the swapping of old bonds into new bonds—as in the cases of Pakistan and Ukraine in 1999—in 2012, in a debt restructuring that was effectively coercive even if a formal default did not take place.

One difference: Argentina was able to stop the recession that started in 1998 and that was turning into a depression by 2001 by both defaulting and exiting the currency peg and allowing massive real and nominal depreciation that rapidly restored its competitiveness, external balance and growth (bearing in mind it also benefited from the good fortune of a commodity boom); Greece, meanwhile, remains stuck in a deep recession (which is becoming a depression) as it is trying to restore its competitiveness through a recessionary “internal devaluation” that reduces wages, prices and unit labor costs (and is also suffering from the ongoing recession in the rest of the EZ).

The two experiences of Greece and Argentina also reveal that the global architecture of international sovereign debt restructuring, guided by the international policy community as it has evolved over the past 15 years, is in crisis. Argentina restructured in an orderly way—after an extremely disorderly default—93% of its public bond debt, but now a minority holdout that has sued the country in U.S. courts is on the verge of winning the battle to be paid in full on its claims.² Thus, Argentina is in the tough position of having to decide whether to pay these holdouts or default again on the creditors that accepted the exchange offer. More seriously, as we will show below, the U.S. judge's new broad and radical interpretation of the *pari passu* clause—as well as his interpretations of sovereign immunity and the obligations of third parties, such as trustees and paying agents—risks destroying the current international regime for the orderly restructuring of sovereign debts of insolvent countries.

² This is not a new legal effort: It has been ongoing since 2005. Judgments have been made every six months since then as the holdout hedge fund Elliot has tried different approaches over time to be paid on its claims.

Greece's PSI (private-sector involvement in debt-crisis resolution) in 2011 led to a reduction—with a number of sweeteners—of the claims held by private creditors but, together with the decision to delay PSI for two years and the ensuing increase in official lending to Greece before and after PSI, also resulted in a surge in the share of public debt owed to official creditors (the IMF, bilateral EU loans, the ECB), thus leaving Greece's public debt as unsustainable as it was before PSI. Now, OSI (official-sector involvement) has become necessary to lower this unsustainable public debt; and, on top of the OSI that has been recently agreed, another round of market-friendly PSI may be needed (most likely in the form of an official-sector-financed debt buyback). However, the terms and conditions of this additional PSI may also become potentially hostage to the U.S. court's radical new interpretation of the *pari passu* clause if this precedent becomes an international norm, even in UK courts.

Argentina had to formally default as the official sector—the IMF and other Paris Club creditors—provided only limited financing and pulled the plug in 2001. The Nestor Kirchner administration then took years before it restructured its debt with an exchange offer, reducing claims by 70%, but leaving the problem of holdouts unresolved. In Greece, meanwhile, a formal default did not occur, while the necessary debt restructuring was delayed for two years: The official sector—with denial of the inevitable contributing to its largesse—first, allowed the exit of all creditors whose claims were coming to maturity by 2011, or—via the ECB's SMP—allowed creditors to exit their holdings of Greek debt before maturity. And even during and after the orderly restructuring of private claims in 2011 (PSI), the official sector continued the additional financing of Greece with credit sweeteners to private creditors and additional commitments to recapitalize Greek banks and to finance the sovereign. So, the current situation is that private creditors' claims on Greece have fallen from close to 100% to about 20%, while the official sector's exposure to Greece has increased from close to 0% to about 80%.

The World Needs a Stable Regime for the Orderly Restructuring of Sovereign Debt

At a time when a few DM sovereigns may be nearly insolvent and even a (small) number of EMs have large stocks of public debt, the fragility of the global architecture for sovereign debt restructurings is clear. How can we ensure orderly restructurings that restore debt sustainability? How can we nudge sovereigns that are likely insolvent into restructurings when they would prefer to gamble on an IMF program in the hope that it would allow them to execute a miracle and avoid a restructuring (an action that, by imposing a delay rather than biting the bullet early, creates greater insolvency down the line)? How can we trade-off between a system that makes restructuring easier and more orderly, but that may cause moral hazard (the debtor's temptation to opt for opportunistic default), and the need to make restructuring hard enough to preserve some creditor rights and appetite for investing in sovereign bonds, and prevent excessive moral hazard? How can we balance the rights of official and private creditors; i.e., how much OSI versus PSI should one have to ensure inter-creditor equity and fairness? And, more importantly, given the Argentine legal situation in U.S. courts, how can we deal with holdouts after a debt restructuring that threatens the rights of creditors that accepted the exchange offer?

The Debate on the Appropriate Architecture for Sovereign Debt Restructurings

The debate on the appropriate architecture for sovereign debt restructurings goes back to the late 1990s, when a number of insolvent or near-insolvent EM sovereigns—Argentina, Russia, Ecuador, Pakistan, Ukraine—needed a restructuring of their unsustainable public debts. There were in principle three approaches to achieving orderly sovereign debt restructurings and avoiding collective-action problems, such as a rush to the exits, a rush to the courthouse, holdout externality, etc.³

³ For a systematic analysis of this debate, see my 2004 book with Brad Setser: "[Bailouts or Bail-ins? Responding to Financial Crises in Emerging Economies](#)," published by the Institute for International Economics.

The Statutory Approach

The first potential option was the “statutory approach” (associated with Anne Krueger—then First Deputy Managing Director at the IMF—in 2001), which initially involved the proposed creation of a new international bankruptcy court for sovereigns (an SDRM or Sovereign Debt Restructuring Mechanism). The final version of the IMF’s SDRM proposal was not a formal international bankruptcy court but, rather, a regime that, using statutory and institutional elements, would allow a comprehensive and orderly restructuring of the foreign public debts of insolvent sovereigns. The effort to create an SDRM failed a decade ago (see [Brad Setser’s paper](#) for a detailed analysis on how and why).

The Contractual Approach Based on Collective Action Clauses (CACs)

Second, a “contractual approach” that introduced CACs in sovereign debts to make restructurings orderly: The key clause to deal with holdouts would be a majority cramdown clause that would bind potential holdouts to accept the same terms accepted by a qualified majority of creditors in a debt exchange. Aggregation clauses applying across different series of bonds could also be introduced, to prevent some bonds from using CACs, while others fail to meet the required threshold, or are bought up by opportunistic investors to block an exchange or bondholder resolution. The problem today is that there are many bonds already in existence without these innovations, not due to mature for years if not decades.

The Market Approach via Exchange Offers Without CACs

Third, a “market approach” that used exchange offers to do orderly restructurings even in the absence of CACs: So the unanimity constraint imposed by existing bonds without CACs was bypassed by offering creditors new bonds that had new financial terms. This market approach did run the risk of ending up with enough holdouts to lead to the exchange offer failing. However, in practice, in almost all of the exchange offers for EM sovereign debts, the terms of the offer were good enough (new bonds worth at least the current market value of existing bonds) that the holdouts ended up being a small fraction of the creditors and, until recently, with very limited options to seize the assets of the sovereign.

Since CACs were not present in most EM bonds issued in the 1990s—especially those under New York law—and since, following a long debate on the merits of an SDRM versus CACs, the official sector decided that creating an SDRM was not politically feasible and that most of the benefits of an SDRM could be achieved with CACs, the practical—although clearly second-best—approach to sovereign debt restructurings needed in the past 15 years was to start with the “market approach” (i.e., orderly debt exchanges before or following a formal default) and then introduce CACs in the new restructured bonds to make future possible debt restructuring more orderly. Even for EMs that did not restructure their debts, the introduction of CACs in their newly issued bonds became regular practice in the last decade, following the active official-sector support of new tools to make restructurings orderly in the absence of an SDRM. But the holdout “problem” was never adequately resolved as exchange offers allowed for such holdouts and CACs were not yet widely present in the old bonds subject to restructuring. Even the introduction of CACs did not eliminate the holdout problem for the future as such CACs—as discussed below—did not include aggregation clauses.

The U.S. Judge’s Ruling Risks Destroying the International Regime for Sovereign Debt Restructurings

The market approach always carried the risk that a minority of holdouts—even after a successful debt-exchange offer—might pursue their legal rights for full payment in court. In fact, the exchange offer documentation explicitly discusses this risk, and there were hundreds of lawsuits in progress against Argentina at the time of the 2005

exchange. But since most creditors accepted the exchange offers and the degree of sovereign immunity was wide enough that holdouts could not easily go to court and seize the sovereign's assets, there was little choice (in the absence of CACs that could cramdown the choices made by a majority of creditors on holdouts), but to pursue debt exchanges and then hope the holdout problem would be manageable – a small “tax” and annoyance, but a useful one from creditors' perspectives, as it made default unpleasant and costly. And, indeed, until the recent Elliott case in U.S. courts (one of a series of recent cases), there was little that holdouts could do to seize the assets of a sovereign in default. Things have radically changed with Judge Thomas Griesa's recent decision (comprising this [order](#), which was then followed by an [opinion](#)) in New York to interpret the *pari passu* clause as implying that a sovereign cannot pay creditors that have accepted an exchange offer unless holdouts are also paid in full.

This radically new interpretation of *pari passu* now allows holdouts to effectively seize an asset that is equivalent to the payments that a sovereign makes to other creditors that have accepted the exchange offer in a debt restructuring. Griesa's ruling thus has created a situation where there is a fight not only between the sovereign and holdouts, but also between creditors—those that accepted the exchange offer and those that held out. Also, the decision creates massive uncertainty in the international regime for sovereign debt restructurings that developed in the last decade to use a market approach—supplemented by CACs in new bonds—to achieve orderly debt restructurings.

Limitations of the Contractual Approach: Lack of a Super-Aggregation Clause

Even the “contractual” approach that was pursued by the official sector did not fully resolve the holdout problem as CACs usually apply bond-by-bond as opposed to the full universe of the bonds issued by a sovereign. So, if the majority “cramdown” vote that binds holdouts occurs bond by bond, a determined holdout could buy a large enough stock of an existing bond to be able to veto the resolution that usually requires a majority of 66-75% of creditors to accept the offer to make the exchange binding on holdouts. The solutions to this holdout problem in a world of CACs are two: Either move to a statutory approach—SDRM—where the international bankruptcy court could impose terms accepted by a majority of all creditors on the minority of holdouts; or introduce “aggregation” or “super-aggregation” clauses in the contractual approach of CACs so that the majority cramdown vote does not occur bond by bond, but rather for the entire universe of the bonds being restructured, including—in the case of super-aggregation—all the relevant foreign jurisdictions where the bonds are issued. With super-aggregation, a single determined holdout would not be able to block a decision taken by a majority of all bondholders any more. The trouble is that, when CACs were introduced in EM bonds—either during restructurings or when new bonds were issued—the majority cramdown clause applied bond by bond; i.e., there is no aggregation or super-aggregation clause as there are legal complications in imposing aggregation clauses on bonds that have not been issued yet, but will be issued in the future, and existing bonds are difficult or expensive to modify. So, in practice, even in the brave new world of bonds with CACs, the lack of super-aggregation—or even aggregation—implies that a determined holdout could corner one bond issue, veto the restructuring of that issue and then pursue its rights for full payment in court. Thus, unless super-aggregation clauses are introduced, only a statutory approach can fully resolve the holdout problem.

Why the Court Rulings Matter for Argentina and Greece, and the Regime for Sovereign Debt Restructurings

The current mess in the global architecture of debt restructurings matters for both Argentina and Greece.

Implications Are Broader Than Just for Argentina

The mess matters for Argentina because the legal actions of a determined holdout are threatening the payments to be made to those that did not hold out. Judge Griesa took an apparently legalistic approach—preserving the

sanctity of the U.S. judicial process—but his interpretation of the *pari passu* clause is radically new and has global consequences, if finally upheld by all the relevant U.S. courts: In future debt restructurings based on an exchange offer (with or without CACs), creditors may be less likely to accept the offer if the new terms of payments that they accepted in the offer are subject to the risk that one holdout may seize them. So, such creditors may be less likely to accept an orderly debt restructuring, making such restructurings much more costly. While on a superficial level the judgment is creditor-friendly, defaults will still occur, and pre-empting them with an orderly exchange would be preferable for debtor and lender alike, rather than a repudiation and ex-post clean-up effort; and even the post-default restructuring is now threatened by the U.S. judge's ruling. The judge's decision also puts Argentina in a most difficult position: Either pay the holdouts in full (today, this is "only" \$1.3 billion due to Elliot, but there is a total of about \$10 billion of debt still held by other holdouts that may lead to similar litigation, further threatening the payments to those that accepted the offer); or not pay the holdout and have its payments due to the creditors that accepted the offer frozen by the U.S. court—as a third party, the paying agent is forced by the court ruling to avoid paying exchange creditors—thus triggering another default on most of its public debt issued in a foreign jurisdiction.

The implications of either choice for future orderly debt restructuring are ominous. The chance that orderly debt exchanges will fail because of the holdout problem is now serious. Why should a creditor accept even a generous exchange offer when a single holdout could block the new payment terms on the new exchanged bonds? And since the CACs do not include super-aggregation clauses even in newly restructured/issued bonds, the risk is that the CAC solution to the holdout problem will fail as—given the U.S. court ruling—a single holdout that blocks the cramdown on a single bond could go after the payments made to those who accepted the exchange offers in court.

Following the U.S. ruling, sovereigns that restructure their debts may decide to switch the jurisdiction of such foreign bond payments to their own country. Indeed, one of Argentina's likely options, if it doesn't want to pay the holdouts and doesn't want to default on the holders of exchanged bonds, would be to change the jurisdiction of the exchanged bonds from New York to Argentina. But that would imply that the current regime of bonds issued by countries in foreign jurisdictions where some of the rights of creditors are widely protected may collapse. Paradoxically, the rerouting of payment to a domestic jurisdiction—or effective "domestication" of debt issued abroad—would reverse the trend where foreign currency bonds of sovereigns have been increasingly issued in foreign jurisdictions. And, anyhow, such a transition would take a long time to be implemented as many EMs may be wary of starting to convert—via exchange offers using CACs—most of their internationally issued debt into a domestic jurisdiction. Thus, future restructuring would likely need to be more coercive, have a very high minimum participation threshold, offer greater recovery value (and thus higher risk of future default and lower creditworthiness) and try to assure restructured bondholders that they will be outside the jurisdiction of any holdouts, among other hurdles.

Implications for Greece

The crisis in the global debt restructuring architecture also matters for Greece as the 2012 debt swap exchanged old bonds that were issued in the Greek legal jurisdiction—where the sovereign had a lot of power to impose an orderly debt restructuring given that domestic legislation could be used and was used to change the financial terms of the old bonds—to new bonds that now, subject to international law (UK), do include aggregation (but not super-aggregation) clauses in the existing new bonds (but not in future ones that Greece may issue if and when it regains market access). Although the existence of aggregation clauses reduces the risk of holdouts, it does not fully eliminate this risk, as it would if a true statutory approach were to be taken.

Moreover, since the size of the OSI that has been recently agreed will not be sufficient to restore the sustainability of Greece's debt (as reducing the interest rate on the loans and re-stretching maturities doesn't provide sufficient NPV debt reduction to make the debt sustainable) and since another round of PSI may be necessary, one of the only options left to Greece and its official creditors is to pursue the expensive option of a voluntary debt buyback of the claims still held by private creditors to reduce its public debt to a more sustainable level. The option of more coercive approaches that use CACs to secure a debt buyback on better terms (or allow another round of traditional PSI based on a second exchange offer) are now more difficult given that the jurisdiction of the bonds has been switched from Greek to English law. It is true that the UK jurisdiction has not yet ruled on how to interpret *pari passu*, but, if the precedent of the New York court were to become a global norm, the consequences for Greece and other orderly debt restructurings in DMs and EMs alike would be serious.

The Mess in the Current Approach Toward OSI in Greece

In the meantime, the lack of a statutory mechanism for orderly restructuring and the willingness of the official sector to finance Greece for two years before the debt-exchange offer occurred created a mess: A large part of the group of Greek private creditors exited early, having either been paid in full when their claims came to maturity or paid partially at high prices when they sold their bonds to the ECB; other private creditors suffered larger losses, but still got a relatively sweet deal as credit enhancements by the official sector and the change in jurisdiction made their claims harder to restructure again; while the official sector may be the biggest loser as, currently, it holds 80% of Greece's debt and significant additional OSI (on top of the most recent round of it), in the form of a face-value reduction of the debt, may be necessary in the next few years.

For now, the official sector has avoided a reduction in the face value of its claims by reducing the interest on its claims and/or stretching out the maturity of such claims; but, eventually, either the official sector lends much more money to Greece to allow expensive market-friendly debt buybacks or it will be forced to eventually accept a reduction in the principal value of its claims on Greece. But such OSI with face-value reduction will be hard in the future as: a) IMF claims on Greece have preferred-creditor status (they are the most senior of all); b) the ECB has taken the stance that "*pari passu*" with private claims (as accepted for the new OMT bond-purchase program) doesn't apply to its purchases of Greek bonds under the SMP; i.e., the ECB expects to be paid in full on the face value of its current Greek bond holdings; c) other official creditors are arguing that accepting a face-value reduction in their claims—those coming from EFSM and EFSF loans—would be against their national law.

So, while traditionally, inter-creditor conflicts have pitted private creditors against official-sector creditors, we are now in a situation where inter-creditor tensions occur even among official-sector ones. Indeed, in the current saga on the debt relief that Greece should or should not get, all of the official creditors have behaved like old-fashioned holdouts expecting to be paid in full on the face value of their claims. Even the partial OSI that stretches maturities and reduces interest rates doesn't bring back Greece to solvency. The holdout behavior of official creditors imposes a debt overhang that impairs value and the restoration of Greece's economic and financial viability.

Conclusion: The Regime for Orderly Sovereign Debt Restructurings Is at Serious Risk Given the Court Decisions

The lessons from the Argentine and Greek cases are that a "market approach" to sovereign debt restructurings is very problematic given the new dynamic caused by the decisions of Judge Griesa.⁴ Because of the new radical

⁴ Argentina, exchange creditors and the paying agents will appeal the latest round of Judge Griesa's rulings at the Courts of Appeals; and the whole matter may eventually end up at the U.S. Supreme Court. The Courts of Appeals may take a different view of what is the appropriate interpretation of *pari passu* and whether the stay should be reinstated. But, given the very tight deadline of December 15 and the intransigent position taken by Judge Griesa, finding in time an orderly solution that prevents

interpretation of the *pari passu* clause, and in particular the remedies ordered upon the sovereign and associated third parties, future orderly restructurings of the debts of insolvent sovereigns may be fraught with danger as creditors that accept an exchange offer may see their payments blocked or seized by holdouts. The paradox is that, if efficient debt exchanges or restructurings were to fail in the future, the holdouts would not have the claims of exchange-bond creditors to seize as they do today, given Judge Griesa's rulings.

Even a "contractual approach" based on CACs is problematic as current CACs don't include aggregation or super-aggregation clauses that minimize the risk of holdout creditors. Thus, [the true and ultimate solution for orderly debt restructuring](#)—that resolves holdout problems and deals with issues of inter-creditor (private and public) equity and fairness in restructuring—may be a true and comprehensive "statutory approach." But when a statutory approach was proposed over a decade ago, the political constraints on agreeing to such a vast global legal scheme—a true international bankruptcy court for sovereigns—led to the proposal's failure. Today, those political constraints are as hard as they were a decade ago; but the need for a truly orderly mechanism for sovereign debt restructuring is just as needed, if not more so. Now, in addition to a small number of EMs, a few DMs may also be nearly insolvent and could require orderly restructuring of their public debts down the line.

In the meantime, the official sector—the IMF, the U.S. Treasury and other DM governments—is asleep at the wheel while a single radical judge in New York threatens to destroy the existing regime for the orderly restructuring of sovereign debts. The official sector may not care much about Argentina (the relationship has been antagonistic for over a decade now), but what is being decided in U.S. courts is relevant not just for a country that some in the private and official sector perceive as a "rogue state." Unless someone senior in the U.S. government starts to pay attention to this serious matter, the risk is that the role of New York as major center for the issuance of international debt by EMs will be threatened and the architecture that the official sector designed in the last decade for the orderly restructuring of sovereign debts will be destroyed, with serious consequences for global financial stability at the time when large public debts in many countries require—more than ever—orderly debt restructuring mechanisms.

David Nowakowski and Arnab Das also contributed to this paper.

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another default by Argentina may not be feasible. In the end, the U.S. Congress may have to use legislation to clarify what *pari passu* means and put a stop to this uncertainty about the debt restructuring regime. But the chance of Congress eventually acting depends on the official sector and the U.S. administration realizing that this is a most serious matter of concern.