EXPLANATORY MEMORANDUM TO

THE DEBT RELIEF (DEVELOPING COUNTRIES) ACT 2010 (PERMANENT EFFECT) ORDER 2011

2011 No. 1336

1. This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 The Order makes permanent the effect of the Debt Relief (Developing Countries) Act 2010 (c. 22) ("the Act"). The Act prevents creditors of Heavily Indebted Poor Countries ("HIPCs") recovering an amount of debt in excess of that consistent with the enhanced HIPC Initiative ("the Initiative"). Full repayment of these creditors diverts the resources provided through debt relief, which are intended to support development and poverty reduction.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Context

4.1 In accordance with section 9(1) of the Act, the Act expires one year after commencement unless it is extended. This Order, which makes permanent the effect of the Act, is to be made by the Treasury under the power conferred by section 9(3) of the Act. Before the Order can be made it must first be approved by a resolution of each House of Parliament. This is to be the first use of the order-making power in section 9(3).

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 The Commercial Secretary to the Treasury has made the following statement regarding Human Rights:

"In my view, the provisions of the Debt Relief (Developing Countries) Act 2010 (Permanent Effect) Order 2011 are compatible with Convention Rights."

7. Policy background

- What is being done and why

7.1 The Initiative was launched in 1996 by the International Monetary Fund ("the IMF") and World Bank with the aim of ensuring that no poor country faces a debt burden it cannot manage. Under the Initiative, the IMF and World Bank calculate the proportionate reduction required in the HIPC's external debts in order to return them to 150% of the HIPC's exports[1], which is considered to be a sustainable level. All creditors – multilateral, bilateral and commercial – are expected to provide the proportionate reduction that will achieve this. At present, the Government, and many governments of other countries, multilateral lenders and commercial creditors do so.

7.2 While many creditors reduce their debts in accordance with the Initiative, some creditors have instead sought to recover the full value of the debt plus accumulated interest and any associated charges owed to them. Full repayment of these creditors diverts the resources provided through debt relief, which are intended to support development and poverty reduction in the HIPC.

7.3 The Act addresses this by preventing creditors from recovering an amount in excess of that consistent with the Initiative. It also promotes the negotiated settlement of these debts on terms compatible with the Initiative by excluding from the scope of the legislation debts where the HIPC debtor does not offer to settle on such terms.

7.4 Evidence suggests that the Act has had some benefit on HIPCs and no evidence has been found of unintended adverse effects. Therefore, it is desirable that the Act should continue to have effect. The option to extend the effect of the Act for one year was considered but discounted, as it could lead to non-participating creditors simply delaying bringing their cases to court. In contrast, making the effect of the Act permanent would further encourage creditors to settle their claims. Extinguishing the possibility of claims being made by non-participating creditors, through settlement on reasonable terms, is the ultimate objective of the Act.

8. Consultation outcome

8.1 The previous Government issued a consultation document – *Ensuring effective debt relief for poor countries: a consultation on legislation* – ahead of passing the Act and published a response to that consultation. It was considered unnecessary to carry out a second public consultation as it would likely present the same range of views on the principled merits of legislating. The sunset clause was primarily introduced so as to ensure that the evidence as to the Act's effects, both intended and unintended, should be reviewed within one year. The sunset clause was not intended to provide an opportunity

[1] Countries with high exports relative to the size of their economy may also qualify under the 'revenue window', if their ratios of exports of goods and services to GDP and fiscal revenue to GDP exceed 30% and 15% respectively. For these countries, a ratio of 250% debt to fiscal revenue is assessed as sustainable and the HIPC Initiative expects the reduction that will lower their debts to this level. Subsequent references in these notes to sustainable levels of debt assume this point.

to re-open arguments of principle. Therefore, officials gathered evidence on the effectiveness of the Act, including through informally consulting with key organisations. Evidence suggests that the Act has had some benefit on HIPCs and no evidence has been found of unintended adverse effects.

9. Guidance

9.1 The Explanatory Notes for the Act and this document provide stakeholders with an explanation of the legislation.

10. Impact

10.1 The Order making the Act permanent does not involve any costs to charities or voluntary bodies, or any additional costs to business.

10.2 The Order making the Act permanent does not involve any costs to the public sector.

10.3 An Impact Assessment has not been prepared for this instrument.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 It is unlikely that the Act will impact many small firms as it only affects firms which hold historic, medium or long term, HIPC debt and which wish to recover an amount in excess of that consistent with the Initiative.

11.3 The previous Government issued a consultation document – *Ensuring effective debt relief for poor countries: a consultation on legislation* – ahead of passing the Act and published a response to that consultation. The assessment was that there is no direct impact on the majority of commercial creditors as they already provide debt relief to HIPCs. The direct impact for those that do not provide debt relief is expected to be minimal. Given that these debts are often 20 years old or more, an original creditor (which would likely be a large financial institution or sovereign) still holding the debt is likely to have written down the value of the asset. Other creditors (including "vulture funds") are likely to have bought the debt at a deep discount, at or below the level that they are still able to recover through the legislation. They may still make a profit by providing the debt relief required under HIPC.

12. Monitoring & review

12.1 The intended outcome of the Order is that non-participating creditors will settle their claims on reasonable terms, thereby reducing the possibility of claims being brought by these creditors. This will be evidenced by fewer creditors recovering an amount in excess of that consistent with the Initiative and an increase in the number of commercial

creditors making use of the World Bank's Debt Reduction Facility. The IMF reports annually on commercial creditor lawsuits against HIPCs.

13. Contact

Helen Walton at HM Treasury Tel: 020 7270 4553 or email: Helen.Walton@hmtreasury.gsi.gov.uk can answer any queries regarding the Order.