



**10th UNCTAD DEBT MANAGEMENT
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Lessons from the Recent Debt Crises

by

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The views expressed are those of the author and do not necessarily reflect the views of UNCTAD



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SOVEREIGN DEBT RESTRUCTURING

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I. Background



II. Recent Experiences of Debt Restructurings



III. Enhanced Sovereign Clauses



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BACKGROUND

Approach to Sovereign Debt Restructuring

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- The Fund approach to SDR derives from its mandate to assist members in resolving balance of payment problems within a timeframe that allows them to return to medium term viability and repay the Fund
- In most Fund supported programs, a combination of policy adjustment and financing from the Fund catalyzes spontaneous financing from the private sector
- SDR can have drastic adverse consequences for economic growth, trade, capital flows, banks and other financial institutions

Sovereign Debt Restructuring

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- Based on Debt Sustainability Analysis that concludes that a macro-economic adjustment program cannot realistically restore sustainability
- The scope of debt relief should be proportional to the country's debt sustainability problem
 - Good faith negotiations to involve private creditors
 - Taking into account spill-over effects on member states

Section II

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RECENT EXPERIENCES OF SOVEREIGN DEBT RESTRUCTURING

Contractual – Market-based Framework

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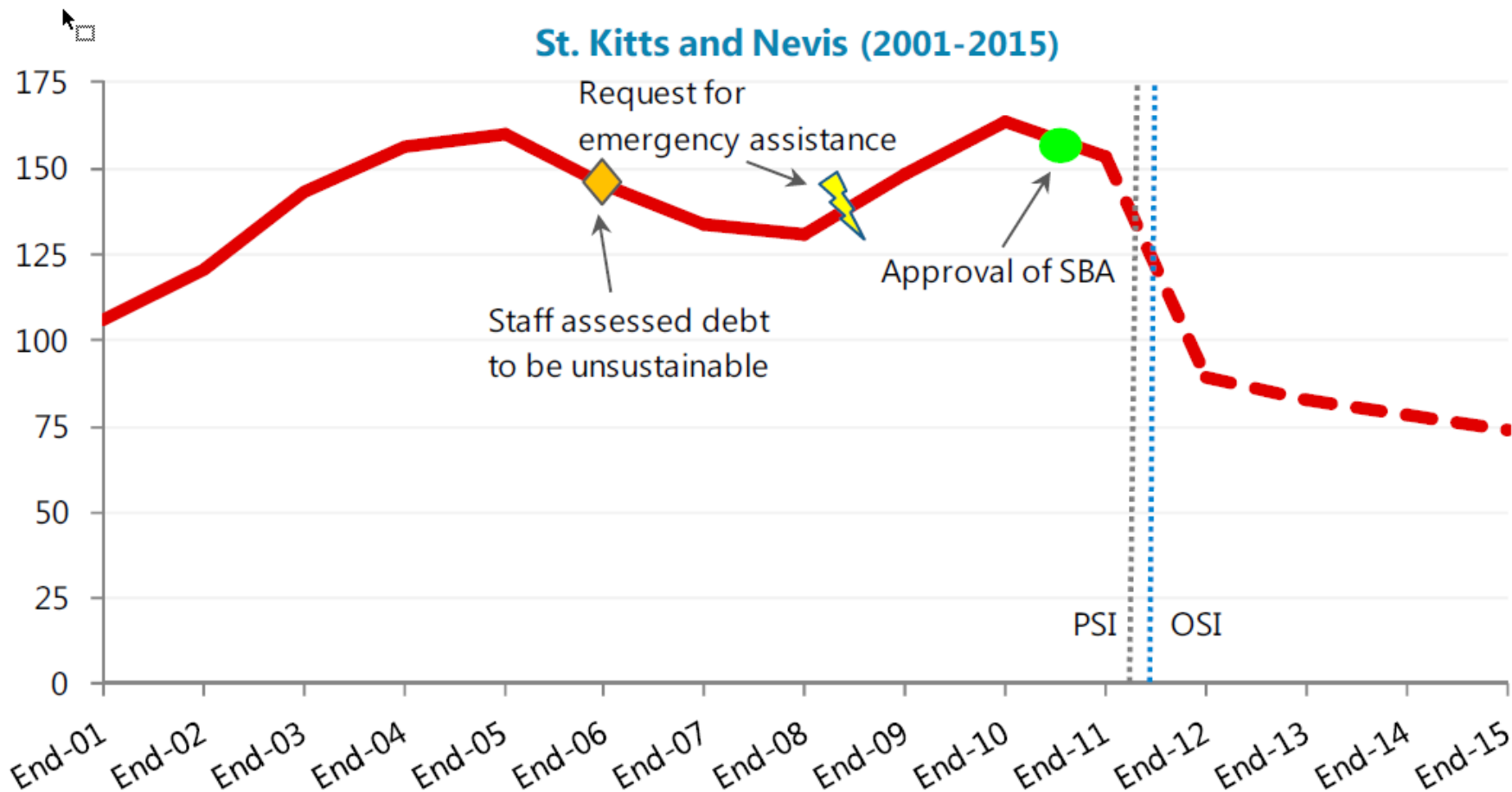
- Experience shows that debt restructurings have often been too little and too late, thus failing to reestablish debt sustainability and market access in a durable way
- Experience also shows that debt restructurings often took place a considerable period after Fund staff had assessed that the debt was unsustainable

Source: IMF 2013, Sovereign Debt Restructuring – Recent Developments and Implications for the Fund’s Legal and Policy Framework

Public Debt-to-GDP and Timeline of Debt Restructuring and Fund Arrangements

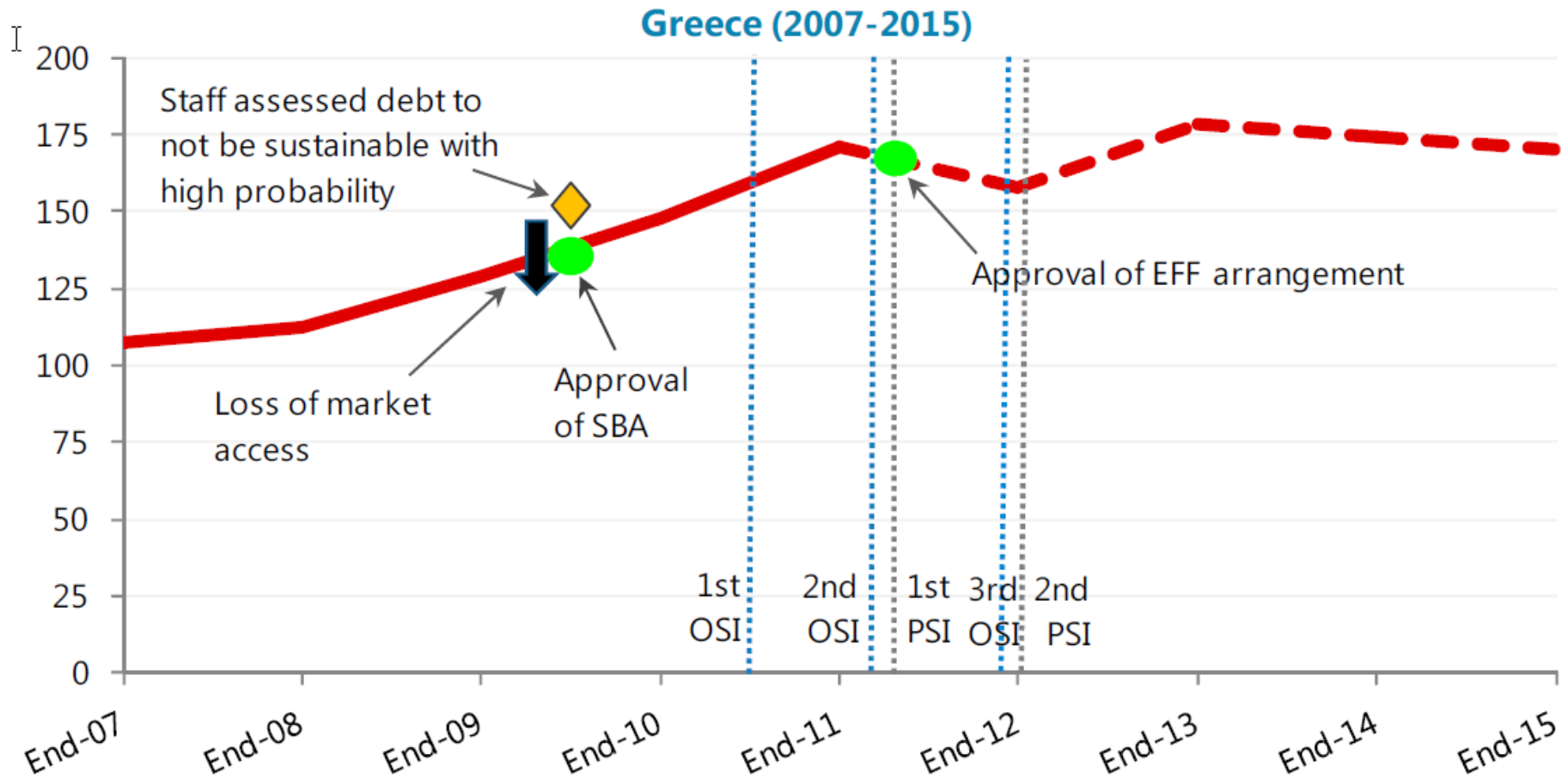
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St. Kitts and Nevis (2001-2015)



Public Debt-to-GDP and Timeline of Debt Restructuring and Fund Arrangements

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Determining Loss of Market Access

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- Assessment of indicators over a period, combined with judgment
- Determining if LMA has occurred and if likely to be reversed
- Made in the context of a debt sustainability analysis
- Looks at indicators such as:
 - Sovereign spreads
 - Patterns of primary issuance
 - Maturity & financing terms
 - Cash balances
 - Sovereign ratings

Selected Examples of Re-profilings

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- Jamaica (2010, 2013)
- Pakistan (1999)
- Uruguay (2003)

Experience of Recent Restructurings

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- Credit participation has been adequate but market based approach is becoming less potent in overcoming collective action problems – particularly in pre-default cases
- Making the contractual framework more effective through
 - Robust aggregation clauses
 - More tight use of Fund financing to the resolution of collective action problems
 - Clarifying the framework for official sector involvement

Source: IMF 2013, Sovereign Debt Restructuring – Recent Developments and Implications for the Fund’s Legal and Policy Framework

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ENHANCED SOVEREIGN CLAUSES

Overview

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- In October 2014 the IMF Executive Board endorsed inclusion of enhanced collective action clauses (CACs) and *pari passu* clauses in new international sovereign bond issuances
 - **Enhanced CAC:** menu of voting procedures: “single-limb”, “two-limb” and “series-by-series”
 - **Modified pari passu:** explicitly disavows “ratable payment”
- Endorsement followed 18-month consultation process with stakeholders. ICMA published model clauses in August 2014
- Board recognized that euro area sovereigns are required by law to include EuroCACs and considered this approach appropriate as most issuances are governed by domestic law

Source: IMF 2015, Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts

Inclusion of CACs

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Substantial Progress Has Been Made:

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- October 1, 2014 - July 31, 2015: **73** international sovereign bond issuances for **\$86 billion**
 - **42 issuances**, representing **60% of nominal principal**, included the enhanced clauses
 - **No observable market impact**



21 issuers included the clauses:

- *English law*: Armenia, Bulgaria, Croatia, Egypt, Ethiopia, Gabon, Kazakhstan, Montenegro, Tunisia and Zambia
- *New York law*: Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Indonesia, Jamaica, Mexico, Panama, Turkey, and Vietnam

Non-inclusion of CACs

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- Issuances can be divided into two categories:
 - “new issuances”: *85% of these issuances included the new CACs*
 - “re-openings and take-downs”: *none included the enhanced clauses*
- Of the *new issuances*, uptake is greater under New York law than English law: **92 percent vs 75 percent**
- **Too early to identify definitive reasons** for non-incorporation and the uptake differential between NY and English law.
- **Other Observations:**
 - Possible lack of awareness/understanding in certain jurisdictions
 - Infrequent issuers
 - Influence of Mexico in NY market

Formulation of CACs

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- Board endorsed “key features”, not specific language, recognizing there would be differences in formulation
- All issuances include the “key features” (e.g., “uniformly applicable,” 75% voting threshold, disenfranchisement, information covenant)
- However, formulation has evolved to reflect use and market preferences
- In **May 2015** ICMA published New York and English law versions of the clauses to achieve two objectives:
 - *Between New York and England, substantive alignment of the key features despite different formulation between the two jurisdictions*
 - *Consistency of formulation within jurisdictions*

Pari Passu

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Modified clause included
as Package with
Enhanced CACs

- All issuances with enhanced CACs include modified *pari passu* – a few have included *pari passu* but not enhanced CACs

Markets view
favorably

- No pricing impact observed

Key Challenge: the Outstanding Stock

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- Value of outstanding stock increased to \$915 billion
- Around 6 percent (\$51 billion) contains enhanced CACs
- Approximately 50% governed by New York law – 39% maturing after 10 years
- Magnitude of risk: depends on future court interpretation of the *pari passu* clause

Trust Structures: Benefits

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- Trusts restrict ability of minority bondholders to disrupt restructuring process, by limiting individual enforcement action:

Acceleration

- Minimum % of bondholders and trustee required to request acceleration

Litigation

- Only trustee can commence legal proceedings against the sovereign on behalf of bondholders

Sharing

- *Pro rata* distribution of litigation proceeds among all bondholders.

Source: IMF 2015, Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts

Trust Structures: Recent Experience

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- Recent increase in use of trusts, especially under New York law
- 45% of issuances since October 2014 under trusts – of these, 83% under NY law
- Not a panacea: trusts do not restrict enforcement action by holdouts remaining after restructuring agreement reached

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TAKEAWAYS

Takeaways

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- Positive changes in the use of enhanced CACs
 - Inclusion of enhanced CACs and modified pari passu clauses
- Consideration should be given to amend existing documentation to include the enhanced CACs
- Monitoring and assessing whether LMOs can accelerate the turnover of the outstanding stock so outstanding stock of debt without CACs is reduced

Annex: Relevant IMF Publications

- International Monetary Fund, “Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts,” IMF Staff Report, September 2015.
<http://www.imf.org/external/np/pp/eng/2015/091715.pdf>
- International Monetary Fund, “The Fund’s Lending Framework and Sovereign Debt—Preliminary Considerations,” IMF Staff Report, June 2014.
<http://www.imf.org/external/np/pp/eng/2014/052214.pdf>
- International Monetary Fund, “Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring,” IMF Staff Report, October, 2014.
<http://www.imf.org/external/np/pp/eng/2014/090214.pdf>
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<https://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf>