SOVEREIGN DEBT RESTRUCTURING

THE ARGENTINE CASE AND THE “BASIC PRINCIPLES” ADOPTED BY UNGA
ARGENTINA IN 2001: CRISIS AND DEFAULT
The increase in public sector external debt was permanent. During the Tequila crisis and economic downturn in 2001, there were major increases in public debt.

*Non-financial National Public Sector*
The collapse of the convertibility generated record levels of poverty and unemployment. The worst occurred in 2002 when, following the devaluation resulting from the currency crisis, GDP fell -10.9% and real wages shrank -18.6% in comparison with the previous year.
ARGENTINA’S SOVEREIGN DEBT RESTRUCTURING PROCESS 2005-2010
Since 2003 Argentina faced the catastrophic consequences of the decisions taken by previous governments and normalized the situation successfully. Moreover, it achieved the highest growing period of the last century, and crucial steps were taken in the regulation of our external debt while at the same time a process of debt reduction was carried out.

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
<th>Details</th>
<th>USD Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>March</td>
<td>Debt restructuring with private holders. <strong>Level of acceptance:</strong> 76%.</td>
<td>27.057 millions</td>
</tr>
<tr>
<td>2006</td>
<td>March</td>
<td>Early debt cancellation with the IMF. <strong>USD 9.500 millions.</strong></td>
<td></td>
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<tr>
<td>2008</td>
<td>September</td>
<td>Paris’ Club. A decree was released that authorized the payment of the debt.</td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>February</td>
<td>Restructuring of secured loans. September: Restructuring of the debt with CER adjustment.</td>
<td>600 millions</td>
</tr>
<tr>
<td>2010</td>
<td>May</td>
<td>Debt restructuring reopening. <strong>Accumulated level of acceptance:</strong> +92.4%</td>
<td>4.347 millions</td>
</tr>
<tr>
<td>2013</td>
<td>October</td>
<td>CIADI. Companies agreement with favorable ruling. <strong>USD 677 millions.</strong></td>
<td></td>
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<tr>
<td>2014</td>
<td>March</td>
<td>An agreement with REPSOL is reached for the 51% nationalization of YPF. <strong>USD 5.000 millions</strong></td>
<td></td>
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<tr>
<td></td>
<td>May</td>
<td>An agreement is reached with the 19 countries of the Paris’ Club. <strong>USD 9.700 millions</strong></td>
<td></td>
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</table>
Sovereign debt restructuring process

Milestones

- **Debt in default:** USD 81.836 millions (2001)
- **Accepted the restructuring:** USD 62.318 millions (2005)
- **Accepted the restructuring:** USD 12.862 millions (2010)

**Around 92.4% of the debt was normalized**
The public debt to GDP ratio dropped from 166% in 2002 to less than 40% in 2013. During 2002, over 95% of the debt was owned by the private sector and multilateral agencies. At present, that percentage dropped to less than half.
### Debt sustainability indicators

<table>
<thead>
<tr>
<th>Ratios</th>
<th>2002</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interests / GDP</td>
<td>3,8%</td>
<td>1,3%</td>
</tr>
<tr>
<td>Interests / Government revenue</td>
<td>21,9%</td>
<td>4,9%</td>
</tr>
<tr>
<td>Public Debt / GDP</td>
<td>166,4%</td>
<td>39,4%</td>
</tr>
<tr>
<td>Foreign Public Debt / GDP</td>
<td>95,3%</td>
<td>11,8%</td>
</tr>
<tr>
<td>Foreign Debt / Foreign Reserves</td>
<td>12 times</td>
<td>4 times</td>
</tr>
<tr>
<td>Foreign Public Debt / Foreign Reserves</td>
<td>836,2%</td>
<td>198,6%</td>
</tr>
<tr>
<td>Foreign Public Debt / Exports</td>
<td>300,6%</td>
<td>62,4%</td>
</tr>
<tr>
<td>% of total debt in foreign currency</td>
<td>79,1%</td>
<td>62,3%</td>
</tr>
<tr>
<td>Average debt maturity</td>
<td>6,1 years</td>
<td>9 years</td>
</tr>
</tbody>
</table>
Argentina is one of the countries that achieved a major debt reduction between 2002 and 2012. The Debt/GDP ratio for Argentina fell 73%, while for the average of the selected countries there was an increase of 38.1%.
WHO ARE THE VULTURE FUNDS?
Sovereign external debt: origins

Bilateral, multilateral and international financial institutions loans to sovereigns

Commercial banks syndicated loans

Emergence of:
- Emerging markets sovereign marketable debt
- Secondary sovereign debt markets

Further development of:
- Sovereign debt issued in the form of bonds
- Secondary sovereign debt markets
- First local currency issues with foreign participation


- Paris Club
- London Club
- Baker plan
- Brady plan
- Latin American debt crises
- Aztec bonds
- Sovereign and currency crises

- World Bank
- IMF
The vulture funds problem: origins

- Holdouts free
- Birth of sovereign debt litigation
- Marketable bonds soar the collective action problem
- Disruptive rulings encourage the emergence of vulture funds


- Holdouts appear in creditor committees of syndicated loans, obstructing sovereign debt restructuring processes.
- Sovereign debt litigation is born.
- Vulture funds infringe the foreign sovereign immunities act: the issuance of public debt becomes a commercial sovereign activity.

- The collective action problem increases as sovereigns issue debt in the form of bonds to an atomized creditor community in different jurisdictions: holdouts multiply.
- Sovereign debt litigation multiplies.
- Vulture funds infringe the Champerty defense.

- Vulture funds are encouraged by disruptive rulings by international courts: special interpretation of pari passu clause is deemed to mean "ratable payment" between creditors rather than "equal treatment".
- Sovereign debt litigation multiplies even more.
The predatory behavior of vulture funds

Main characteristics

- The lack of an international regulatory framework for sovereign debt restructurings has allowed highly speculative funds, commonly called "vulture funds", to take advantage of systemic gaps with the aim of bypassing successful restructuring agreements and the principles applicable to these contexts.

- "Vulture funds" are professionals of worldwide financial speculation; they seek usurious profits at the expense of countries facing economic and financial difficulties, regardless of whether their actions can generate new crises that hinder other creditors’ collection or worsen the living conditions of the inhabitants of those countries.

- “Vulture funds” are not good faith investors but rather entities entirely prepared to withstand high costs on lawyers, financiers and lobbying, in return for windfall profits.
The vicious circle of vulture funds

COUNTRY OVERLEVERAGED AND INSOLVENT

DEFAULT

Funds purchase debt at low price

RESCEDULING AND DEBT SWAP

MAJORITY ACCEPTANCE

VULTURE FUNDS

DEBT RELIEF
Peru

Further Experiences

Default 1992
Restructuring 1995
1996 NML Elliott buys securities in default. **180 eligible creditors, only 2 litigated.**
Peru loses judicial dispute in the Court of New York

NML Elliott

Bought defaulted securities for USD 11,4 millions
Collected USD 58,4 millions
Gain of 400%
Elliott bought defaulted titles from Congo for a nominal value of USD 30 million.

- Bought securities for nearly USD 2.6 million.
- Gets in United Kingdom judgment for more than USD 100 million.
- Seizes oil exports for USD 39 million.

Gain of 1400%
2012 Dart buy Greek bonds prior to the restructuring of its debt (March 2012).

The restructuring is accepted by 97% of the creditors.

- Buy assets amounting close to €283 millions.
- Refuses the Exchange and charge €435 million.

Gain of 53.8% between March and May 2012.
Some of the countries attacked by vulture funds
Sovereign debt litigation: a rising trend

Sovereign restructurings with litigation:

Source: Schumacher, J.; Trebesch, C. & Enderlein, H. (2014), Sovereign Defaults in Court
ARGENTINA AND VULTURE FUNDS
Argentina is one patent victim of the vulture funds

- With the support of the US judiciary, these speculative groups, that they bought securities short before or after the default (even during the restructurings processes), have managed to force the meaning of the pari passu clause —which can be found in countless bonds still outstanding worldwide—, with the aim of hindering the successful restructuring of Argentina's debt, reached with more than 92% of its creditors.

- The negative impact of vulture funds’ activity is undeniable. As a consequence of their usurious strategy against Argentina, they seek to collect an approximate amount of U$D 1.6 billion, in one of their judicial disputes, which represents a 1600 % profit. This amount, together with other claims presented in related proceedings, could rise to, approximately, U$D 15 billion.
Vulture Funds Claim

2008
Bought defaulted debt
NML 48,7 USD millions

1608% aggregated rate of return

2014
U.S. Justice recognizes
NML 832 USD millions
Vulture Funds Claim

428 USD MILLIONS

AURELIUS 33%
NML 52%
BLUE ANGEL 13%
OTHERS 1%

ORIGINAL PRINCIPAL

RULING

1500 USD MILLIONS
INCLUDING PRINCIPAL, COMPENSATORY AND PENALTY INTERESTS RECOGNIZED BY U.S. COURTS
Vulture Funds Claim

This ruling implicates debt of 1,500 USD millions plus 15.000 USD millions including the total of bonds still in default.
Vulture Funds Claim

+15,000 USD MILLIONS
ARE EQUIVALENT TO

→ 52% OF CENTRAL BANK’S FOREIGN RESERVES
→ 20% OF ARGENTINE ANNUAL EXPORTS
→ 30% OF ARGENTINE PUBLIC DEBT WITH THE PRIVATE SECTOR

AR$ 3100 DEBT INCREASE PER INHABITANT
THE NEED FOR A STATUTORY SOLUTION
The contractual solution?

- The **contractual approach** to the collective action problem focuses on the modification of standard contractual clauses used in sovereign debt instruments.

- **Collective Action Clauses (CACs)** have been adopted since 2003 and amended as of 2014.

- CACs, however, proved not to be a complete solution:
  - Stock problem: USD 100 billions maturing in the next 10 years with no CACs under NY law.
    - No effective solution for vulture funds strategies: they can sill block restructurings.
    - No guarantee of a uniformity of criteria nor avoidance of legal fragmentation.
  - No possibility to provide and regulate interim financing.
<table>
<thead>
<tr>
<th>Date</th>
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<tr>
<td>Junio</td>
<td>Belgium approves Vulture-proof Law</td>
</tr>
<tr>
<td>Agosto</td>
<td>Debtors and creditors agree on new debt contracts that defines new CACs and clarifies the interpretation of the pari passu clause</td>
</tr>
<tr>
<td>Septiembre</td>
<td>UN starts the discussion on sovereign debt restructuring processes</td>
</tr>
<tr>
<td>Julio</td>
<td>The Parliament of the Kingdom of Belgium approves by unanimity a law against the activities of vulture funds. The law is effective since 13/9/2015.</td>
</tr>
<tr>
<td>Septiembre</td>
<td>UNGA adopts “basic principles” for sovereign debt restructuring processes</td>
</tr>
</tbody>
</table>

- The US Supreme Court decides not to consider the Argentine Case.
- As the result of a proposal made by G77+China, at the UN starts the discussion on sovereign debt restructuring processes.
- On 10/9/2015 the UNGA adopted the “Basic Principles for the Restructuring of Sovereign Debts”. 
The **UNGA** is the most **democratic, representative** and **equititative** organ in the international system.

- It has the advantage of **addressing the sovereign debt problem in a comprehensive way**.
- It allows an **integrated vision**, comprising all possible angles.
- It has **no conflict of interest** as it is not a lender nor a borrower.
- It is not a new topic for the UNGA since it has several resolutions in this regard.
1. **A Sovereign State has the right**, in the exercise of its discretion, **to design its macroeconomic policy, including restructuring its sovereign debt**, which should not be frustrated or impeded by any abusive measures. Restructuring should be done as the last resort and preserving at the outset creditors’ rights.

2. **Good faith** by both the sovereign debtor and all its creditors would entail their engagement in constructive sovereign debt restructuring workout negotiations and other stages of the process with the aim of a prompt and durable reestablishment of debt sustainability and debt servicing, as well as achieving the support of a critical mass of creditors through a constructive dialogue regarding the restructuring terms.

3. **Transparency** should be promoted in order to enhance the accountability of the actors concerned, which can be achieved through the timely sharing of both data and processes related to sovereign debt workouts.
4. **Impartiality** requires that all institutions and actors involved in sovereign debt restructuring workouts, including at the regional level, in accordance with their respective mandates, enjoy independence and refrain from exercising any undue influence over the process and other stakeholders or engaging in actions that would give rise to conflicts of interest or corruption or both.

5. **Equitable treatment** imposes on States the duty to refrain from arbitrarily discriminating among creditors, unless a different treatment is justified under the law, is reasonable, and is correlated to the characteristics of the credit, guaranteeing inter-creditor equality, discussed among all creditors. Creditors have the right to receive the same proportionate treatment in accordance with their credit and its characteristics. No creditors or creditor groups should be excluded *ex ante* from the sovereign debt restructuring process.

6. **Sovereign immunity** from jurisdiction and execution regarding sovereign debt restructurings is a right of States before foreign domestic courts and exceptions should be restrictively interpreted.
7. **Legitimacy** entails that the establishment of institutions and the operations related to sovereign debt restructuring workouts respect requirements of inclusiveness and the rule of law, at all levels. The terms and conditions of the original contracts should remain valid until such time as they are modified by a restructuring agreement.

8. **Sustainability** implies that sovereign debt restructuring workouts are completed in a timely and efficient manner and lead to a stable debt situation in the debtor State, preserving at the outset creditors’ rights while promoting sustained and inclusive economic growth and sustainable development, minimizing economic and social costs, warranting the stability of the international financial system and respecting human rights.

9. **Majority restructuring** implies that sovereign debt restructuring agreements that are approved by a qualified majority of the creditors of a State are not to be affected, jeopardized or otherwise impeded by other States or a non-representative minority of creditors, who must respect the decisions adopted by the majority of the creditors. States should be encouraged to include collective action clauses in their sovereign debt to be issued.”
VOTES

- **136** In favour
- **41** Abstain
- **6** Against
- **10** Absents