Africa’s rising debt

Session 4. Restructuring sovereign debt

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Sovereign debt restructuring – Where to after the Principles?

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Three pillars of UNCTAD, Debt and Finance branch of GDS

Consensus building
- Eg PRSLB
- FfD follow-up process

Technical co-operation
- Eg DMFAS, Capacity building
- SDGs, PRSLB

Research
- Interdisciplinary policy analysis, debt and finance issues, PRSLB
UN Principles on Responsible Sovereign Lending and Borrowing

2009-2015
Funded by Norwegian Governments
2009-2012
Development of Principles
2012 Endorsement and Roadmap

"Principles"

Roadmap

Good faith
Transparency
Impartiality
Legitimacy
Sustainability

Debt workout mechanism
Implementation
OBJECTIVES
Help prevent financial meltdown
Facilitate equitable restructuring
Debtor left in position to grow
We reiterate that debtors and creditors must work together to **prevent and resolve** unsustainable debt situations. Maintaining sustainable debt levels is the responsibility of the borrowing countries; however, we acknowledge that lenders also have a responsibility to lend in a way that does not undermine a country’s debt sustainability. In this regard we take note of the **UNCTAD principles on responsible sovereign lending and borrowing**.

We will work towards a **global consensus on guidelines for debtor and creditor responsibilities in borrowing by and lending to sovereigns**, building on existing initiatives.

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**Reference**

European Parliament A8-0129/2018 (§ 27)

Endorses the principles set out by UNCTAD for responsible credit policy, which highlight in particular the shared responsibility of creditors and borrowers (UNCTAD Principles on Promoting Responsible Sovereign Lending and Borrowing), and calls on the EU to support the implementation of the UNCTAD Principles; believes that (the principles) should be turned into legally binding and enforceable instruments.
UN Basic Principles on Sovereign Debt restructuring Processes

Sovereignty – macro policy
Good faith
Transparency
Impartiality
Legitimacy
Sustainability
Equitable treatment
Sovereign immunity
Majority restructuring

Resolution A/RES/69/319

G-77 initiative – Argentinian-led

UNCTAD - secretariat to Ad hoc Committee in UN General Assembly

Voted resolution, 120 for, 6 against and 41 abstentions

Adopted 10 September 2015
Way forward for PRSLB and SDRP

• As soft-law:
  • In the absence of a coherent multilateral legal framework – soft law has a role to play – while not legally binding – voluntary, self-imposed – observance rather than compliance
  • Advantages – Flexibility, informality and pragmatic
  • Disadvantages – Discretionary – uncertainty and predictability
  • Proliferation of standards – inconsistency/overlaps/gaps
Way forward for PRSLB and SDRP

- As UN process – has the advantages:
  - Involves the member states of the United Nations – inclusive, ownership, repeatedly embraced in GA resolutions and similar documentation
  - Breadth – both lender and borrower
  - Well researched, consulted
  - Scope – sound international legal principles, embraces other guidelines and market related approaches
- But now a question of implementation
  - As EU parliament “priority must be given to ending irresponsible practices” and “binding and enforceable deterrents”
  - Requires country leadership and intergovernmental processes to progress.
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To restructure or to bail out?
Who African government external debt is owed to (mean, unweighted, average)

- China: 31%
- Paris Club: 16%
- Other governments: 15%
- World Bank: 4%
- IMF: 4%
- Other multilateral institutions: 10%
- Private sector: 4%
IMF 2015 predictions for Ghana debt service

External debt service as percentage of government revenue

- Baseline
- One shock
- IMF threshold
IMF 2018 predictions for Ghana debt service

External debt service as percentage of government revenue

- 2015 baseline
- 2018 baseline
- IMF threshold
IMF 2018 predictions for Ghana debt service

External debt service as percentage of government revenue

- 2015 baseline
- 2018 baseline
- IMF threshold
- One shock
Chad debt service post-restructuring
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Policy goal: Debt crisis prevention and stabilization in stress periods

Prevention
1. Information
2. Standardization
3. Liability management

Stabilization in stress periods
1. Provision of safety valves in contracts to allow creative solutions
2. Reducing the threat of holdouts and litigation through contractual arrangements for bonds and commercial bank loans
3. Improving process – role of trustees vs. Fiscal agents
4. Role of IMF – LIA policy
Reforms in contractual technology for bonds

• The introduction of CACs in bond issues following the failure of the SDRM in 2003
  (CAC allows a supermajority of bondholders within a series of bonds to agree to a debt restructuring that is legally binding on all holders of the bond, including those who vote against the restructuring)

• New aggregated CACs (endorsed by IMF and G20 in 2014)
  (allowing majority bond voting mechanisms to operate across multiple series of bonds, thereby ensuring minorities across series of bonds can be crammed down in order to minimise any holdout creditor problems)

• Standardized *pari passu* provision (endorsed by IMF and G20 in 2014)
  (disavowing any ratable payment interpretation (as was followed in the case of Argentina)}
Commercial bank loans (CBL)

• Replicate progress in bond contracts in CBL
• No apparent reason why the new *pari passu* language should not be equally relevant in the loan agreement context
• Broader trading entities not covered by legislation – makes cohesive solutions difficult
• Innovations in CBL contracts can reduce the likelihood of a holdout and “mitigate the problem of too little too late.”
CBL features

- Syndicated bank loans are just amended or refinanced.
- Syndicated bank loans – a majority can accelerate the loan.
- On amendment, synd. bank loans still normally require a **unanimous consent on payment terms**.
• Introduce assignment clause to avoid debt falling into the hands of unscrupulous creditors
• Reword amendment clause to mean supermajority and not unanimity
• New pari passu language in CBL
• Introd. Sharing clause – proceeds from litigation by any shared equally with all to mitigate the threat of litigation
• Limit jurisdiction
Recovery values and effectiveness of creditor Committees

- Estimates of recovery values vary according to the point of time the discount rate is selected and utilized in the calculations. Information on the price at which the bond is bought or when sold or held till yields go down to reflect higher recovery values missing.

- The example of Ecuador illustrates that cash flow recovery is higher after a restructuring compared to cash flows resulting from the original contract, evidence that the debtor pays a price for restructuring its debt.

- On creditor–debtor engagement during a restructuring, no evidence that outcomes are better or worse for debtors with or without engagement with a Creditor Committee.

Sources:
LEGEND

- **Ecuador Default Dates:**
  1) 08/2000
  2) 12/2008

- **Ecuador Bond Exchange Deal closed:**
  1) 08/2000
  2) 06/2009
  *used as discount rate*

**Graph:**
- **Yield %**
- **Avg. Yield 11.4% (8 Years)**
- **Decrease after 14 months**
First Default 1999
Cash Flow Eurobond 2002
91% Buyback of Eurobond 2012
Second Default 2008
424.96
196.88
118.12
348.52
in $ million
Jan-97 Jan-99 Jan-01 Jan-03 Jan-05 Jan-07 Jan-09 Jan-11
Original
Principal Value
Eurobond 2002
Cash Flow Eurobond
Jan-01 Cash Flow Eurobond 2002
Jan-03 First Default 1999
Jan-07 Second Default 2008
Jan-09 91% Buyback of Eurobond 2012
Jan-11
References


Other issues

- New bond clauses in existing stock of debt
- New debt instruments
- Standstills through contractual technology
- Process questions – trustees, engagement
- Role of IMF, LIA policy and good faith criterion
- Regulation

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RESTRUCTURING SOVEREIGN DEBT
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AFRICA’S RISING DEBT
OVERSEAS DEVELOPMENT INSTITUTE, LONDON
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Brief Overall Summary

Much has been done recently

Sovereign Debt Roundtable (sovereign bonds). Broad objective to address holdout creditor risk, following the cases of Argentina and Greece. Output of Roundtable:

- Aggregated collective action clauses (ability to vote different series of bonds together)
- Enhanced *pari passu* clause (disavow rateable payment interpretation)

Further evolution of market based contractual provisions (tends to be incremental and in response to practical problems).

Result:
- Very considerable improvement in financial architecture since October 2014.
What more could be done with sovereign bonds?

First, documentary:

- Increased use of trustees (broadly only the trustee can initiate legal proceedings)
- Increased use of express creditor engagement provisions
- Include Roundtable outputs in bonds issued under laws beyond English and NY – e.g. German, Japanese, Swiss
- Sukus

Secondly, practical:

- Ensure sovereign debtors consistently adopt new norms (including with above documentary features)
- Consider dealing with legacy stock (especially if some small ‘orphan’ issuances)
- When issue locally under local law ensure comparable features are incorporated
What more could be done with other types of debt?

First, loans - documentary:

▪ Start using *pari passu* provision which disavows rateable payment interpretation
▪ Start debate concerning majority amendment (currently requires 100%)
▪ Remove creditor engagement event of default
▪ Presumption of grant of waiver request if there is a delay in responding

N.B. Syndicated loans have sharing clauses (unattractive for holdouts - dampen litigation)

Secondly, loans - practical:

▪ Discourage use of bilateral loans (no sharing clause) or syndicated loans with a single lender (defeats purpose of sharing clause)
▪ Engage with Loan market Association and Loan Syndications & Trading Association on documentary changes

N.B. Most banks now hedge their lending in some way
Other types of financing

Notable existing financings:

- Commodity linked
- Often with GMRA or other ‘derivative’ arrangement – takes outside of negative pledges
- Use of an asset to gain priority and take outside restructuring where asset value is greater than debt

Notable new suggested financings:

- Bonds with interest or principal deferral (quasi equity or state contingent debt or hurricane bonds)
- Bank of England / Bank of Canada work on GDP linked bonds
- Clarity of triggers and verification
- Market appetite and ‘sensible’ pricing
- Tax and regulatory treatment
- Preferable to standstill provisions – the latter cause issues with credit downgrades, credit event for CDS, Accounting impairment and cause associated regulatory capital concerns for regulated holders
Avoiding shocks –

Transparency of information

Bond market - transparency is the norm.

Financial markets - Initiative underway but need to recognize genuine concerns:
- Client confidentiality (multiple laws)
- Need debtor cooperation through comprehensive waiver of confidentiality
- Anti-trust concerns
- Competition concerns

Debtor could make biggest contribution by adhering to one of the IMF’s data dissemination standards.

Other Official Sector:
- IMF Policy on lending into private sector arrears

Previously sanctioned/used techniques in sovereign debt restructurings:
- Use of temporary exchange or capital controls (particularly where there is domestic banking crisis)
- UNSCR (Iraq 1483, 1546) to limit private creditor remedies
- Changing local law (to retrofit majority voting into local law governed bonds)
- Legislation aimed at limiting recoveries in certain circumstances (e.g. UK HIPC Act / Belgian Vulture fund legislation)
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