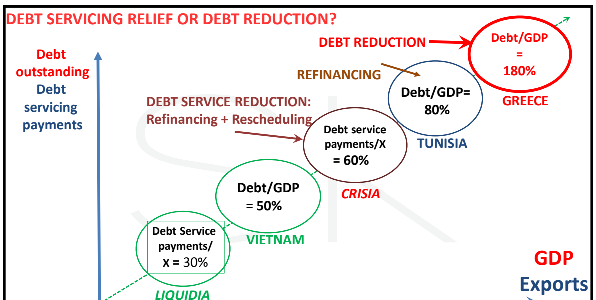
SKEMA BUSINESS SCHOOL

Country risk and External Debt Restructuring

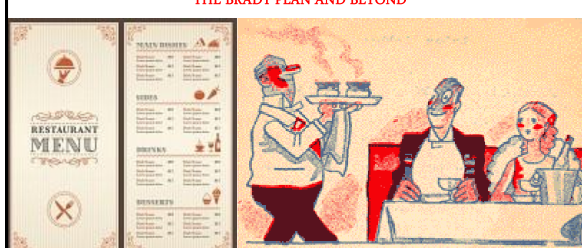
Michel Henry Bouchet

DEBT SERVICING RELIEF OR DEBT REDUCTION?



MENU-BASED DEBT RESTRUCTURING

THE BRADY PLAN AND BEYOND



THE 1989-2017 BRADY PLAN OF LONDON CLUB DEBT RESTRUCTURING

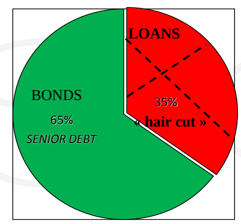
- **London Club banks** grant debt relief to debtor nations, in some proportion of secondary market discount through interest or debt stock reduction
- Accounting and regulatory incentives (loan-loss provisioning)
- Shift to specific purpose financing and voluntary lending
- **Debtor countries** adopt tough macroeconomic adjustment programs under the monitoring of the IMF/WB (SALs)
- Current account financing + Reserve build-up
- Objective: back to market-access for EMCs or to grants for low-income countries

Means and Tools

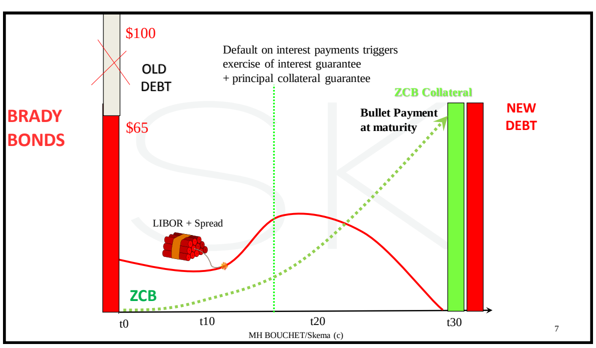
- Defaulted sovereign London Club debt to be exchanged for easily tradeable **Brady bonds** guaranteed by 30-year zero-coupon US Treasury bonds which the defaulting nation purchases with its reserves and official financing support (IFIs + Paris Club)
- Principal guarantee + x semi-annual interest payments, whose guarantee is rolled over
- **Bullet repayment** (e.g., 30 years)
- **Cross-default clause**
- **Debt conversion clauses**

THE BRADY PLAN IN ACTION

New senior debt with long-term maturity, principal collateralization, rolling interest guarantee, and cross-default clause



Debt cancellation backed up by commercial banks' reserves for loan-losses with regulatory incentives



Types of Brady Bonds

- **Buybacks at discount**
- **Par Bonds** *Maturity:* Registered 30 year bullet issued at par *Coupon:* Fixed rate semi-annual below market coupon *Guarantee:* Rolling interest guarantees from 12 to 18 months. Principal collaterallized by U.S. Treasury zero-coupon bonds
- **Discount Bonds (DB)** *Maturity:* Registered 30 year bullet amortization issued at discount *Coupon:* Floating rate semi-annual LIBOR *Guarantee:* Rolling interest guarantees from 12 to 18 months.
- **Front Loaded Interest Reduction Bonds (FLIRB)** *Maturity:* Bearer 15 to 20 year semi-annual bond. Bond has amortization feature in which a set proportion of bonds are redeemed semi-annually. *Coupon:* LIBOR market rate until maturity. *Guarantee:* Rolling interest guarantees generally of 12 months available only the first 5 or 6 years.

TYPES OF BRADY BONDS

- **Debt Conversion Bonds (DCB)** *Maturity:* Bearer bonds maturing between 15-20 years. Bonds issued at par. *Coupon:* Amortizing semi-annual LIBOR market rate. *Guarantee:* No collateral is provided
- **New Money Bonds (NMB)** *Maturity:* Bearer bonds maturing 15-20 years. *Coupon:* Amortizing semi-annual LIBOR. No collateral
- **Past Due Interest (PDI)** *Maturity:* Bearer bonds maturing 10-20 years. *Coupon:* Amortizing semi-annual LIBOR. No collateral
- **Capitalization Bonds (C-Bonds)** Issued in 1994 by Brazil's Brady plan. Maturity: Registered 20 year amortizing bonds initially offered at par. Coupon: Fixed below market coupon rate stepping up to 8% during the first 6 years and holding until maturity. Both capitalized interest and principal payments are made after a 10 year grace period.

VIETNAM = LONDON CLUB DEBT RESTRUCTURING

Brady debt restructuring (12/97)=

- (P= 335 million) + (PDI= 515) *interest arrears*

= **$850 million**

- 30-year bonds with 50% discount + par bonds + buyback at 44%

Paris Club Debt Restructuring 12/1993: LONDON Terms = 54% debt reduction

SNAPSHOT AT VIETNAM'S GOVERNMENT SECURITIES

VIETNM (12 Found) Cpn Typ All Mty Typ All Exclude None

Issuer	Coupon	Maturity	Series	Rtg	Freq	Mty Type	Cntry	Curr	Ask Px
1)VIETNAM (REP OF)	6.875	01/15/16	REGS	B+	S/A	BULLET	VN	USD	106.2500
2)VIETNAM (REP OF)	6.875	01/15/16	144A	B+	S/A	BULLET	VN	USD	106.2500
3)VIETNAM-PDI	VAR	03/12/16	US	NR	S/A	SINKABLE	VN	USD	N.A.
4)VIETNAM-PDI	VAR	03/12/16	18YR	NR	S/A	SINKABLE	VN	USD	88.0000
5)VIETNAM (REP OF)	6.750	01/29/20	REGS	B+	S/A	BULLET	VN	USD	101.5000
6)VIETNAM (REP OF)	6.750	01/29/20	144A	B+	S/A	BULLET	VN	USD	102.2500
7)VIETNAM-PAR	3.750	03/12/28	US	NR	S/A	CALL/SINK	VN	USD	N.A.
8)VIETNAM-PAR	4.000	03/12/28	30YR	B+	S/A	CALL/SINK	VN	USD	75.0000
9)VIETNAM-DISC	FLOAT	03/13/28	30YR	B+	S/A	BULLET	VN	USD	84.0000
10)VIETNAM-DISC	FLOAT	03/13/28	US	NR	S/A	BULLET	VN	USD	N.A.
11)VIETNAM-DM LOAN	0.000	12/29/49	DM	NR	S/A	CALL/SINK	VN	DEM	N.A.
12)VIETNAM-US$ LOAN	0.000	12/29/49	US$	NR	S/A	CALL/SINK	VN	USD	N.A.

VIETNAM'S 30-YEAR BRADY BOND 1998-2028 (AS OF 10-2017)

Floating-rate US$ Brady bond, with principal repayment secured by 30-year zero-coupon US$ bond collateral + rolling interest payment guarantee

THE GREEK 2011-13 MENU-BASED « BRADY DEBT RESTRUCTURING »
= 65% « *HAIR CUT* »

1. **Par Bond** Exchange into a 30 year instrument (4% coupon)
2. **Par Bond** with refinancing of rolling-over maturing Greek government bonds over 30 years
3. **Discount Bond** Exchange into a 30 year instrument with 20% discount and 5% coupon
4. **Discount Bond** Exchange into a 15 year instrument with 5,9% coupon
5. **Buyback** at 35% price (65% discount) of London Club debt (11/2012)

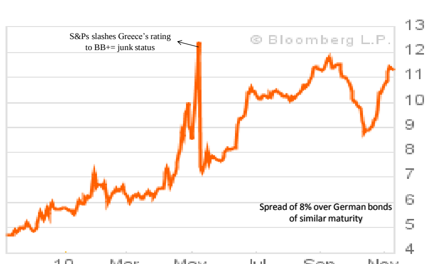
- For instruments, 1, 2 and 3 the principal is fully collateralized by 30 year zero coupon AAA Bonds.
- For instrument 4, the principal is partially collateralized through funds held in an escrow account.

Calculation: IIF & http://www.voxeu.org/index.php?q=node/6818

CHALLENGES OF THE GREEK DEBT RESTRUCTURING WORKOUT 2011-17

- 1. *Pari passu*: Private investors insist that government bail-out lenders would be treated the same way as the private sector, to lessen the risk of another cut in their payouts down the line
- 2. New bonds issued to private investors as part of the hair cut to be governed by London rather than Greek law
- 3. Threat of free riders and legal actions: VEGA Hedge Fund

MARKET PRICE OF RISK: YIELD ON GREECE'S 10-YEAR BONDS
2009-2010



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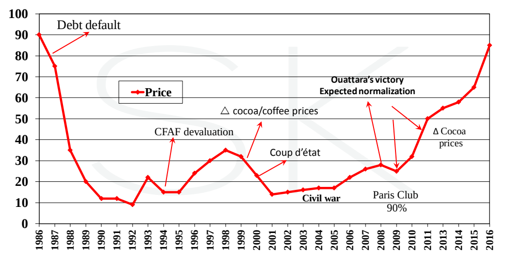
IVORY COAST'S BANK DEBT RESTRUCTURING SAGA

- 03/1998 - Ivory Coast issued six bonds totalling $2.4 billion under the Brady scheme in a restructuring of outstanding external commercial debt.
- 09/2000 - Default on the bonds, following a coup in 1999.
- 03/2009 - The IMF and the World Bank declared Ivory Coast eligible for debt relief under the HIPC (highly indebted poor countries) initiative.
- 03/2009 - Paris Club agreement leading to immediate cancellation of $845 million in debt (80% debt relief)
- 04/2010 - Debt exchange of the defaulted Brady bonds, replacing the old bonds with a $2.3 billion bond due 2032, with semi-annual coupon payments.
- 11/2010 - Presidential run-off ballot : Gbagbo is declared winner = civil war
- 12/2010 - World Bank freezes funding
- 12/2010 - Ivory Coast does not make $29 million coupon payment on $2.3 billion bond. Failure to pay = "event of default"

IVORY COAST'S SECONDARY MARKET DEBT PRICE
(1986-2016 IN % OF FACE VALUE)



UKRAINE'S DEBT RESTRUCTURING

09/2015

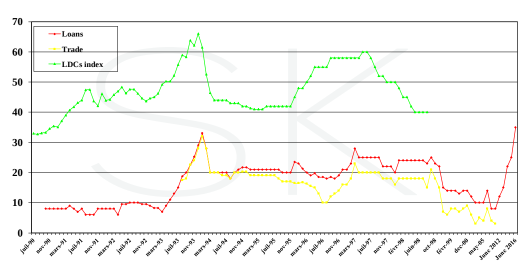
- 20% write off on $18 billion of bonds, condition for the IMF to press ahead with 4-year $40 billion package
- Main creditors: PTG Pactual, T Rowe Price, TCW, Franklin Templeton…
- Inclusion of GDP-linked instrument
- Between 2021-40 investors will receive up to 40% of the value of economic growth >4%

BRADY BONDS PRICES AFTER RESTRUCTURING NEGOTIATIONS

Arg Par	48.000	50.000
Arg FRB	41.000	42.000
Arg '27	31.000	33.000
Brz C	75.250	75.437
Brz '27	72.750	73.000
Bul IAB	85.000	85.500
Mex Par	93.000	93.250
Pol Par	75.250	76.250
Rus '28	107.750	108.000
Ven DCB	78.250	78.750
Vie Par	44.000	45.000

SECONDARY MARKET PRICES OF CUBA'S LONDON CLUB DEBT

(1990-2016 in percent of face value)



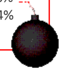
HYPER-EXOTIC DEBT PRICES

- Myanmar 20%
- Cambodia 20%
- Mongolia 22%
- North Korea 10%

- Argentina (2033 bonds)= 62% following ruling by NY court in 11/2012)
- Cuba Loans 10-35%
- Cuba Trade 15%
- Albania 36%
- Bosnia 36%
- Serbia 44%

- Irak Bonds 90%
- Libya 25-35%
- Syria 6-11%
- Yemen 30%

- Angola 60%
- Ethiopia 60%
- Senegal 35%
- Sudan 11-14%
- Uganda 14-16%
- Zimbabwe 1-4%



EMCS SECONDARY MARKET DEBT PRICES

COUNTRY / ISSUE	Low Price	High Price
Africa Hyper-Exotics		
Angola / Trade	50.000%	55.000%
Angola / Loans	55.000%	59.000%
Cameroon / Trade (non-HIPC)	14.000%	20.000%
Congo / Trade (non-HIPC)	22.000%	26.000%
DR Congo / Loans, Trade (non-HIPC)	16.000%	20.000%
Ghana / Trade (non-HIPC)	78.000%	82.000%
Kenya / Trade	39.000%	49.000%
Mozambique / Trade (non-HIPC)	20.000%	26.000%
Senegal / Loans, Trade (non-HIPC)	12.000%	16.000%
Sudan / Loans (non-HIPC)	11.000%	14.000%
Tanzania / Loans, Trade (non-HIPC)	10.000%	13.000%
Uganda / Trade (non-HIPC)	14.000%	16.000%
Zambia / Loans, Trade (non-HIPC)	13.000%	20.000%
Zimbabwe / Trade	1.000%	4.000%
Latin America & Caribbean Hyper-Exotics		
Cuba / Trade	2.000%	4.000%
Cuba / Loans	5.000%	10.000%
Suriname / Loans, Trade	14.000%	18.000%

COUNTRY / ISSUE	Low Price	High Price
Eastern Europe Hyper-Exotics		
Azerbaijan / Trade	18.000%	23.000%
Bosnia / Trade	36.000%	41.000%
Georgia / Trade	11.000%	15.000%
Serbia / Trade	44.000%	54.000%
Turkmenistan / Trade	23.000%	33.000%
Ukraine / Trade	18.000%	25.000%
Uzbekistan/Trade	20.000%	24.000%
Middle East Hyper-Exotics		
Egypt Trade	65.000%	75.000%
Iraq / Paris Club	84.000%	89.000%
Iraq / Bonds	91.000%	92.000%
Libya / Trade	25.000%	35.000%
Syria / Trade	6.000%	11.000%
Asia Hyper-Exotics		
Mongolia / Trade	22.000%	30.000%
North Korea / Loans, Certificates	9.000%	12.000%

Weak Liquidity:

Angola, Nicaragua, Cameroon, Albania, Congo, Tanzania, Zaire (Rep. Democr.), Zambia, Iraq, North Korea

Limited Liquidity:

Cuba, Egypt, Jordan, Madagascar, Panama, Jamaica, Ivory Coast, Senegal

Moderate Liquidity:

Nigeria, Morocco, Costa Rica, Bulgaria, Peru, Russia, Vietnam

Good Liquidity

Brady Bonds + Eurobonds= Argentina, Brazil, Ecuador, Mexico, Philippines, Poland, Venezuela. South Africa, Turkey

Debt trading and EMTA

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For Immediate Release

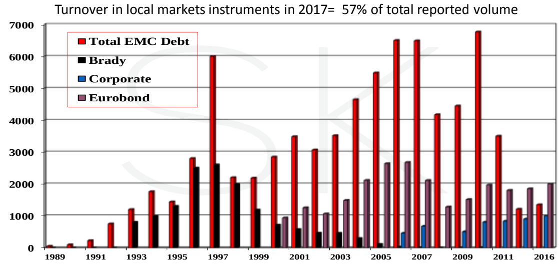
EMTA SURVEY:
QUARTERLY EMERGING MARKETS DEBT TRADING
AT US$1.132 TRILLION

Volumes Decline 17% on Year-on-Year Basis

NEW YORK, September 19, 2017—Emerging Markets debt trading volumes stood at US$1.132 trillion in the second quarter of 2017, according to a report released today by EMTA, the trade association for the Emerging Markets debt trading and investment industry. This compares with US$1.357 trillion reported for the second quarter of 2016, a 17% decrease, and down 14% from US$1.323 trillion reported in the first quarter.

EMERGING MARKET DEBT TRADING 1989-2016 (US$ BILLION)

Turnover in local markets instruments in 2017= 57% of total reported volume



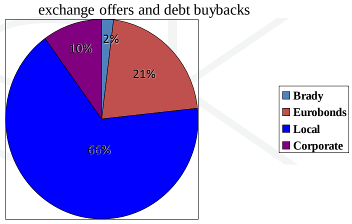
Source: EMTA-London

WHO'S WHO IN HIGHLY DISCOUNTED AND EXOTIC DEBT TRADING?

1. **Trading**: FH International (Eric Herman), Omni Bridgeway (Amsterdam, Geneva, Singapore, London, Guernesey), MarketAxess, Société Générale, BNP, Lazard Brothers
2. **Holdout creditors** and « *vulture funds* »: hedge funds that seek to enforce contractual claims against distressed sovereign debtors through litigation: they buy defaulted government debts on the cheap and refuse to join in a restructuring, "holding out" for a better deal and sue for the full amount (***pari passu clauses*** promise equal treatment of creditors preventing EMCs from paying its restructured bondholders but not hedge funds: i.e., borrower's promise to ensure that the obligations will always rank equally in right of payment)
3. Key players: NML Capital (Argentina), Paul E. Singer's Elliott Capital Management (Argentina), Aurelius Capital Management (Argentina's 2001 $132 billion default, Peru), Franklin Templeton, BlueMountain Capital, Stone Lion Capital, Monarch Alternative Capital, Canyon Capital, First Tree Partners, Marathon Asset Management (Puerto Rico, Greece), Dart (Brazil), Greylock Capital (Venezuela).

TRADING VOLUME BY INSTRUMENT TURNOVER

Bradys transactions which accounted for 50% of debt trading in the mid-1990s have shrunk due to early redemption, exchange offers and debt buybacks



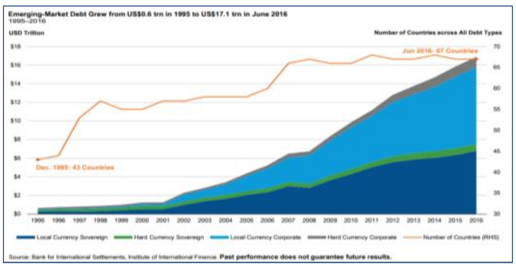
THE EVOLVING STRUCTURE IN THE SECONDARY DEBT MARKET

MARKET SHARE COMPARISON

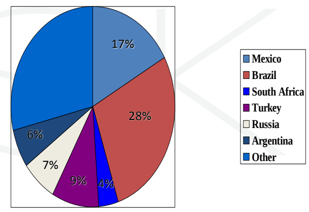
	2005	1997
Eurobonds	48%	23%
Local Instruments	47%	25%
Options and Warrants	2%	6%
Brady Bonds	2%	41%
Loans	>1%	5%

Source: EMTA

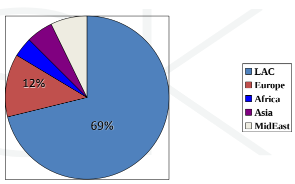
EMERGING MARKET LOCAL CURRENCY BONDS 1995-2017



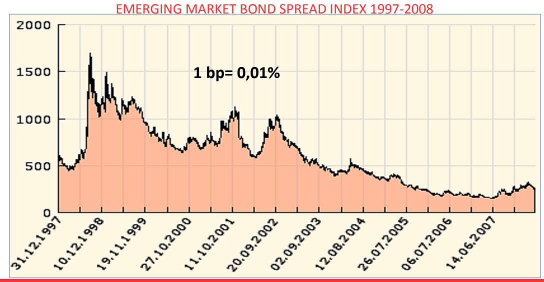
TRADING VOLUME BY COUNTRY (EMTA)



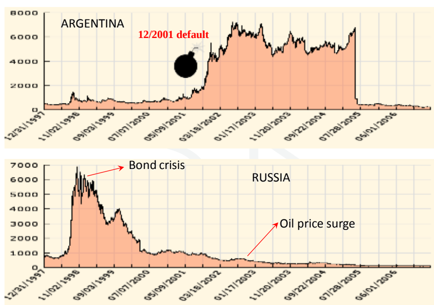
TRADING VOLUME BY REGION



ASIAN + RUSSIA + ARGENTINA CRISES
EMERGING MARKET BOND SPREAD INDEX 1997-2008



ARGENTINA'S AND RUSSIA'S SHRINKING SPREADS 1997-2008



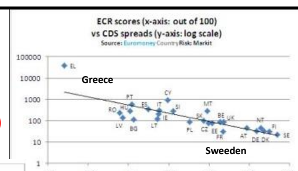
RISK CONTAMINATION = BRAZIL AND PERU 5-YEAR CDS PRICES: THE GLOBAL SPILL-OVER EFFECT 2006-2012

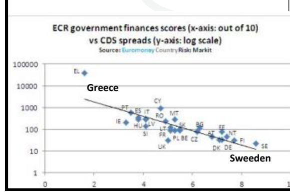
600 bp= $600,000 to insure $10 million/year

CDS IN 2016-17?

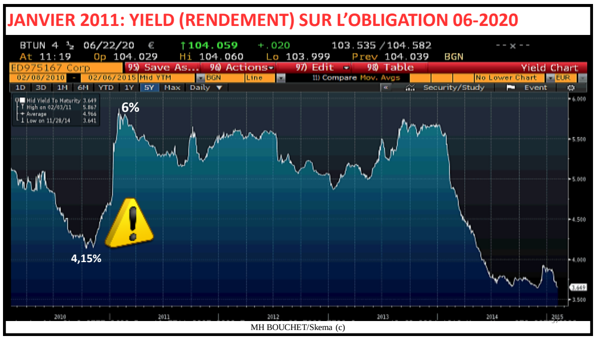
Nigeria CDS spread of 590 bp implies that it costs $590,000/year to insure $10 million worth of debt

CDS SPREADS AS EARLY COUNTRY-RISK WARNING INDICATORS
(EUROMONEY COUNTRY RISK SCORES)



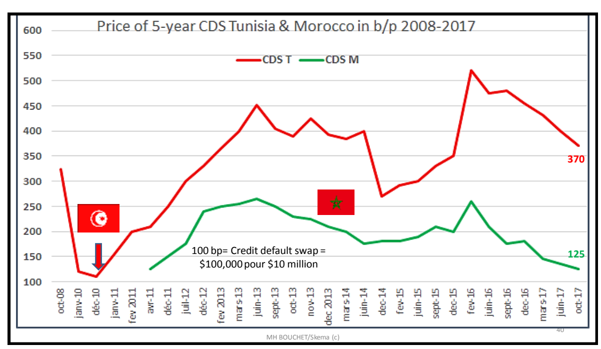


CDS spread of 200 bp implies that it costs $200,000/year to insure $10 million worth of debt

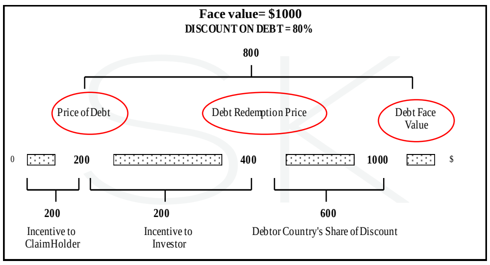

JANVIER 2011: YIELD (RENDEMENT) SUR L'OBLIGATION 06-2020
BTUN 4 ½ 06/22/20 € ↑104.059 +.020 103.535 /104.582
At 11:19 Op 104.029 Hi 104.060 Lo 103.999 Prev 104.039 BGN
Yield Chart
6%
4,15%
MH BOUCHET/Skema (c)


VOLATILITÉ DU YIELD SUR L'OBLIGATION SOUVERAINE DE LA TUNISIE 2025 $1 MILLIARD
Yield Chart
Mid Yield To Maturity 6.150
High on 02/09/16 8.587
Average 6.463
Low on 04/10/15 5.159
Etat d'urgence prolongé
+ congrès Nidaa Tounes à Sousse
+ gouvernement Habib Essid
2015
2016
2017
MH BOUCHET/Skema (c)

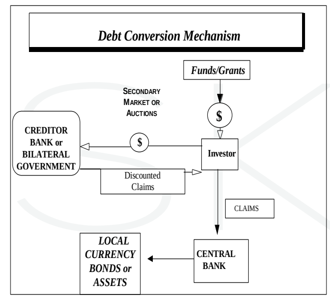

BTUN CDS USD SR 5Y D14 370.000 357.500 /382.500
At 13 Oct Source CMAN
Bar Chart
Last Price 370.000
High on 02/29/16 520.275
Average 377.059
Low on 11/11/14 259.345
2013
2014
2015
2016
2017
MH BOUCHET/Skema (c)

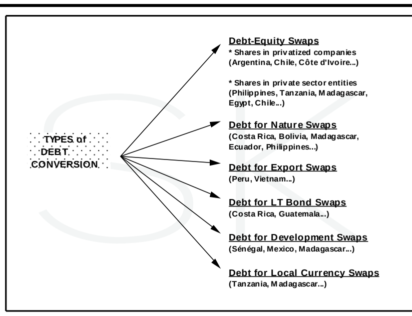

Price of 5-year CDS Tunisia & Morocco in b/p 2008-2017
CDS T
CDS M
370
125
100 bp= Credit default swap =
$100,000 pour $10 million
MH BOUCHET/Skema (c)

DEBT CONVERSION: A POSITIVE SUM GAME?



Source: Bouchet/OSF





Source: Bouchet/OSF

CORPORATE DEBT SWAP TRANSACTIONS

- 04/2001: South Korea's largest builder HEC (Hyundai Engineering & Constr.) makes a debt swap with its creditors to reduce debt ratios from 1240 % to 250%, by issuing new shares and bonds to creditors as a part of the rescue package after Hyundai reported losses >US$2.2 billion that wiped out its equity capital!

POSITIVE SUM GAME!

- Debtor: debt cancellation with local currency payments while stimulating foreign direct investment and enhancing the role of private sector activity in the local economy (privatization)
- Creditor: cleaning up of portfolio with upfront cash payment while accounting losses get absorbed by loan-loss reserves
- Investor: access to local currency at a discounted exchange rate that boils down to an investment subsidy, thereby mitigating the overall country risk and the specific project risk