Le Club de Londres et la restructuration de la dette bancaire

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Global Finance

Why does the crisis erupt? Gross and Net Flows

- **Gross Capital Inflows** = Long-Term + Short-term capital flows
- **Net Flows**= Gross Inflows - Principal Repayments
- **Net Transfers**= Net Flows - Interest Payments
- **Total debt service payments**= Principal payments + Interest payments

External Debt Analysis: The dual face of Country Risk

- ***Liquidity Risk***
- Debt Service Ratio:
- (P+I/X)
- Interest Ratio (I/X)
- Current account/GDP
- Reserve/Import ratio
- Import/GDP ratio
- Growth rate of exports/ Average external interest rate

- ***Solvency Risk***
- Debt/Export ratio
- Debt/GDP ratio
- ST Debt/Reserves

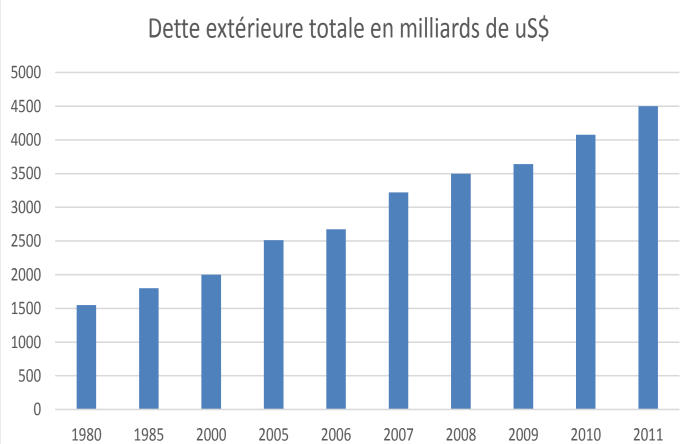
Liquidity and Solvency: the two-fold challenge

- Solvency= « Stock squeeze »!

  Debt/GDP Debt/Exports
- Every year, even though the principal payments might be refinanced, the cost of debt is equal to: average interest rate x debt stock
- Liquidity= « Flow squeeze! »

  Debt Service ratio <25% of X
- Key 1 is maintaining the average growth rate of exports > average rate of interest on external indebtedness in order to stabilize the Interest/Exports ratio!
- Key 2 is having the rate of return of debt-financed domestic investment > the external interest rate

Endettement extérieur des pays "émergents"



The external debt overhang

- Total Debt= US$4500 billion

$1000 billion **low-income countries** < $965 per capita	$3500 billion **middle-income countries** $965<gdp<$9360

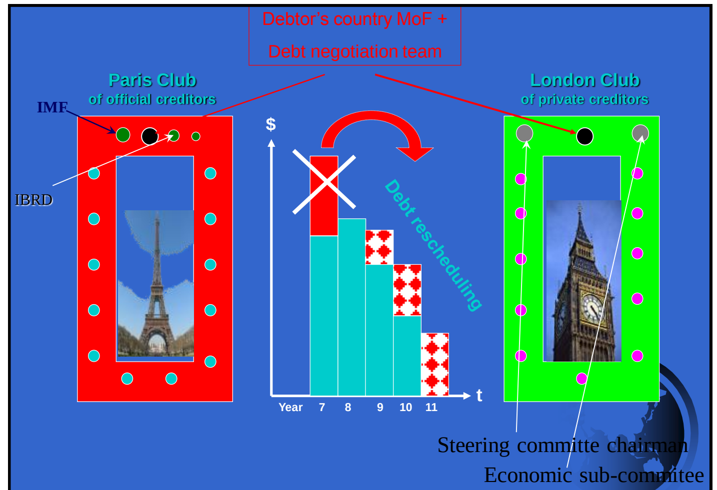
The debt burden is concentrated in a group of 15 "heavily indebted middle-income countries": Mexico, Venezuela, Argentina, Brazil, Poland, Nigeria, Russia, Philippines, Indonesia….

WHO?

Five main groups of private and official creditors:

- **The IFIs: the IMF and the World Bank**
- **The Paris Club of OECD governments**

- **Private suppliers: trade debt**
- **The London Club of international banks**
- **Institutional investors (pension and investment funds): Eurobond holders**



Le Club de Londres

Debt restructuring of London Club debt

☞Commercial banks' claims on EMCs and the debt renegotiation workouts

What is the « London Club »?

- Since the 1970s, countries facing default have used the London Club process to restructure sovereign debt owed to banks.
- The London Club has evolved as an ad hoc forum for restructuring negotiations. Each London Club is formed at the initiative of the **debtor country** and is dissolved when a restructuring agreement is signed.
- Ad hoc London Club "Advisory Committees" are chaired by a leading financial bank.
- Recently, Advisory Committees have included representatives from nonbank creditors (fund managers holding sovereign bonds)

What is the « London Club »?

- *ad hoc* forum for restructuring negotiations.
- Each London Club is formed at the initiative of the debtor country
- London Club "Advisory Committees" are chaired by a leading financial firm with representatives from a cross-section of international banks
- Meetings in London, New York, Paris, and other financial centers.
- IIF + Economic Subcommittee = macroeconomic, BOP analysis and debt sustainability reports to the Advisory Committees

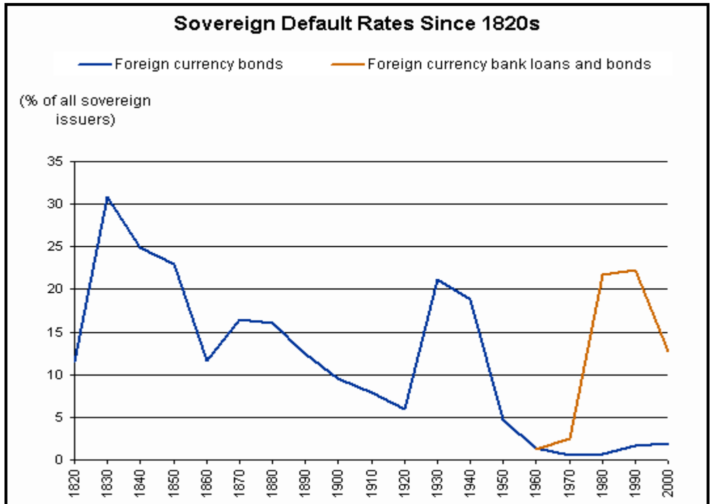
Source: IIF

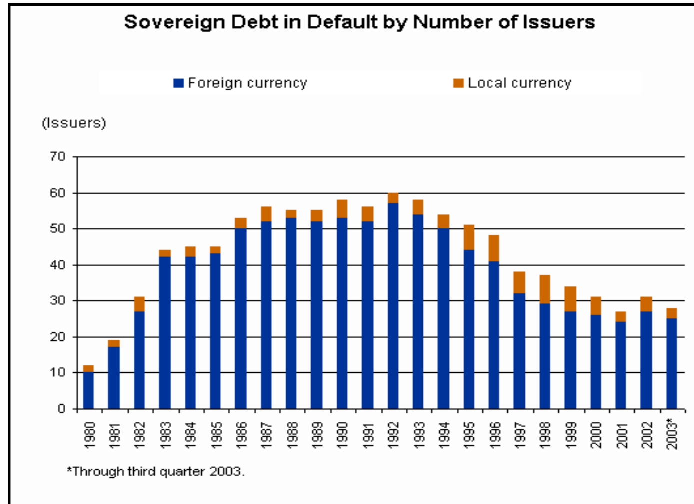
What is the IIF?

- The Institute of International Finance, Inc. (IIF), is the world's only global association of financial institutions.
- Created in 1983 in response to the international debt crisis, the IIF has evolved to meet the changing needs of the financial community.
- Members include most of the world's largest commercial banks and investment banks, as well as insurance companies and investment management firms. Among the Institute's Associate members are MNCs, trading companies, ECAs, and multilateral agencies.
- The Institute has more than **450 members** headquartered in more than 70 countries.

Emerging Market Economies: Capital Flows
$ billion

	2011	2012e	2013f	2014f
Capital Inflows				
Total Inflows, Net:	*1145*	*1113*	*1173*	*1209*
Private Inflows, Net	1084	1080	1118	1150
Equity Investment, Net	528	572	616	646
Direct Investment, Net	524	499	517	536
Portfolio Investment, Net	4	73	99	110
Private Creditors, Net	556	508	502	504
Commercial Banks, Net	177	143	152	175
Nonbanks, Net	379	365	351	329
Official Inflows, Net	61	33	55	59
International Financial Institutions	17	0	18	22
Bilateral Creditors	44	33	37	37
Capital Outflows				
Total Outflows, Net	*-1445*	*-1427*	*-1390*	*-1359*
Private Outflows, Net	-721	-975	-1016	-1026
Equity Investment Abroad, Net	-221	-314	-342	-371
Resident Lending/Other, Net	-499	-661	-675	-655
Reserves (- = Increase)	-666	-378	-374	-333
Memo:				
Net Errors and Omissions	-58	-74	0	0
Current Account Balance	*300*	*314*	*217*	*150*

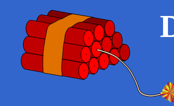




The complexity of London Club Debt Restructuring

- Key issues: **Liquidity vs. Solvency crisis**, flow relief vs debt stock reduction, financial rescue packages, systemic risk, free riders, and moral hazard….
- How to enforce solidarity with hundreds of short-term profit-oriented international banks that aim at maximizing gains and shareholders value?

Liquidity + Solvency Crisis = Debt Overhang



- Banks reacted in 1982, 1989, 1997 and 2001 by cutting abruptly sovereign lending including short-term trade credits and working capital lines.

- Provisioning and charge-offs have played a major role in shrinking new lending (with tax and accounting support provided by OECD governments and … taxpayers)

London Club Debt Restructuring

At the inception of Mexico's debt crisis, back in 1982, phenomenon of <u>double concentration</u> by banks and by debtor countries.

Banks were undercapitalized and overexposed!

Risk of systemic crisis as the debt of Mexico + Brazil > capital of US money-center banks

Need to strike an optimal combination of adjustment + external financing

In 1982, total commercial bank debt amounted to about US$250 billion. Two-thirds of that debt was concentrated in Latin America and that same share was concentrated in the 15 "severely middle-income countries" (i.e., Mexico, Argentina, Venezuela, Brazil, Chile, the Philippines, Nigeria...).

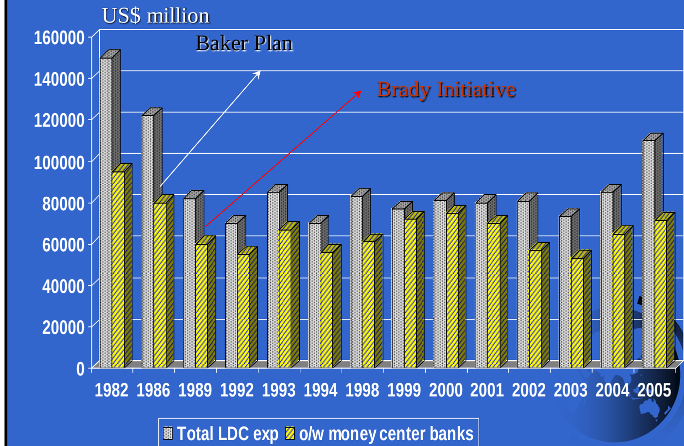
From the side of the commercial bank creditors, the debt was heavily concentrated in the portfolio of about 10 large "money center" banks, both <u>overexposed and undercapitalized</u>. For many banks LDC assets were larger than equity. In other words, a chain reaction of defaults by a few large debtors could create a "systemic risk" of insolvency crisis in the international banking community. Hence, their future was in jeopardy.

The essence of the so-called "Baker Plan" of October 1985 precisely was to rely on the forced solidarity between debtor countries and creditor banks.

The rationale was to convince banks to join defensive lending operations, thereby marginally increasing bank exposure in order to preserve the quality of existing assets. International banks had to provide more loans to be sure to get repaid.

The objective was to provide LDCs with both money and time: money through new loans and time through long-term rescheduling packages. This strategy has been called "involuntary" or "concerted" lending.

US bank lending to EMCs



Source: FFIEC

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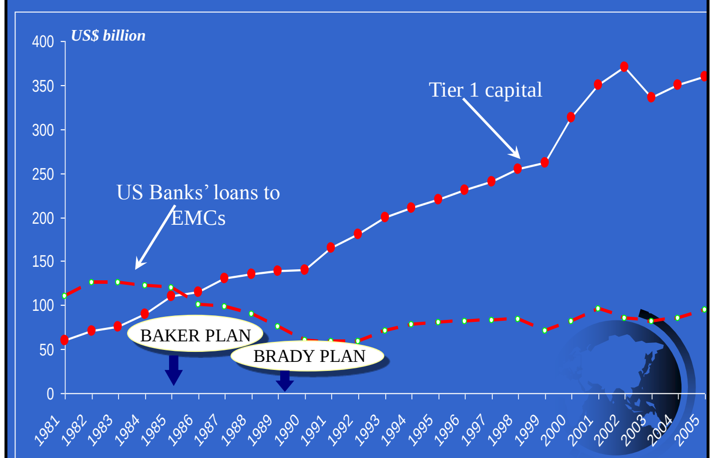
US banks cut lending to EMCs... while improving capital ratios!



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OCDE COUNTRY	RESERVE LEVELS	TAX REDUCTION	CAPITALISATION	NUMBER OF COUNTRIES
FRANCE	58%	Yes Maxi 60%	Yes	42
BELGIUM	60% mini	No	No	50
CANADA	35% mini	Yes Maxi 45%	No	43
GERMANY	70%	Yes	No	AD-HOC
JAPAN	30%	1% only	29%	38
NETHERLAND	45%	Yes	No	
SWITZERLAND	70%	Yes	No	90
UNITED-KINGDOM	65%	Yes 50%	No	Matrix
UNITED6STATES	58% money-center	No	Yes	AD-HOC

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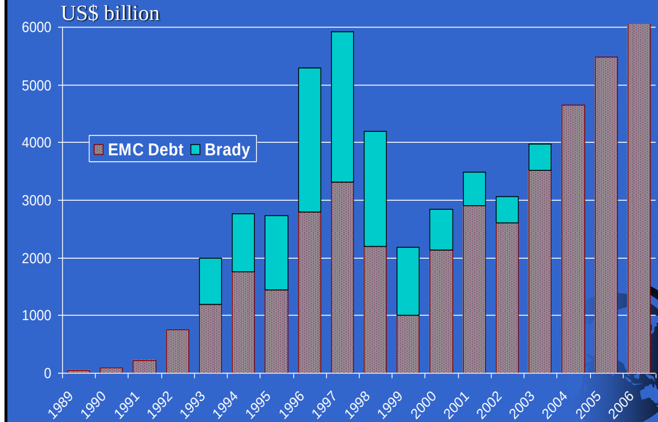
Trading volume in Secondary Market of EMC's debt



Source: EMTA

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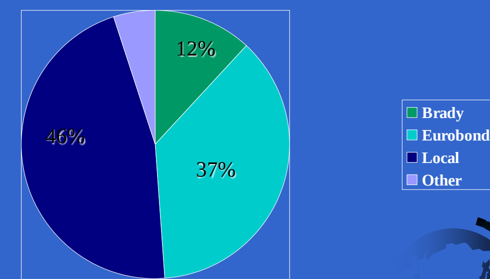
Trading Volume by instrument



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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 2006

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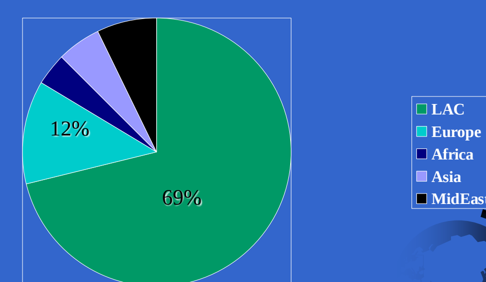
Trading Volume by Region



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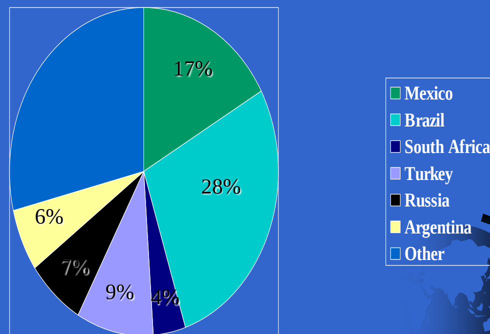
Trading Volume by Country (EMTA)



Weak Liquidity:

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

Limited Liquidity:

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

Moderate Liquidity:

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

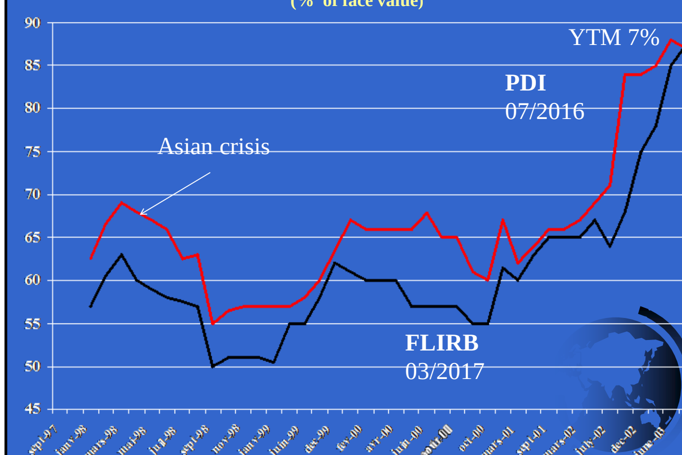
Good Liquidity

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

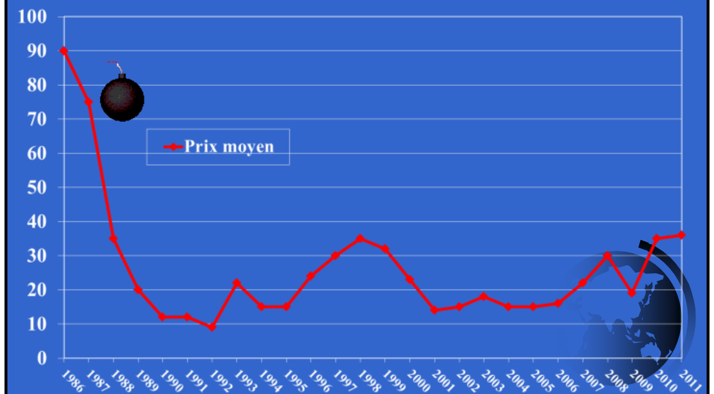
Wesbruin Corp's composite EMC's debt index

PERU: London Club Debt's Secondary Market Price

(% of face value)



Evolution du prix de la dette de la Côte d'Ivoire en % de la valeur faciale



Initial Responses to managing the Debt crisis were flawed on three grounds:

<u>First</u>, the Baker Plan (new money + time) met with limited success for it treated the debt crisis as purely one of illiquidity, rather than one of insolvency.

<u>Second</u>, the crisis containment strategy was mainly focused on a select group of 15 highly indebted (mostly) middle-income countries.

<u>Third</u>, the official approach underestimated the *inertia* of the banking system. Banks went on *strike* regarding the new money calls of the US Treasury. Banks started to build up provisions, therefore strengthening their ability to withstand arrears accumulation. The international banking system got much stronger during the 1980s and 90s. Mergers and acquisitions strengthened the banking system.

From Debt Refinancing to Debt Reduction: A Turning Point in the Debt Strategy

<u>Diagnosis</u>

Debt Overhang = Solvency Crisis: the debt crisis acts like a tax on current and future export earnings, thereby discouraging domestic investment and savings mobilization, and fueling capital flight.

<u>Solution:</u>

The failure of the "new money approach" of the Baker Plan led, in early 1989, to debt reduction. The <u>Brady Plan</u> consisted in an official proposal for market-based and voluntary debt reduction, the terms of which would be negotiated between debtors and official (Paris Club) and commercial bank (London Club) creditors.

Debt Restructuring Instruments: the Market-based Menu Approach

How can one make international banks accept "voluntary" write down?

- **Clearly, the Baker Plan was a failure because it assumed that banks would join new money operations more or less voluntarily. In practice, a growing number of banks turned out to be "free riders", i.e., they simply refused to increase their exposure and they managed to receive debt payments that other banks accepted to refinance.**
- **The 1989-2002 Brady Plan is a shift from debt refinancing to market-based debt reduction.**

The 1989 Brady Plan

- Objective: defaulted sovereign London Club bank loans would be exchanged for collateralized, easily tradeable 30-year bonds, with bullet repayment
- London Club banks would grant some amount of debt relief to debtor nations, in some proportion of secondary market discounts.
- The new Brady bonds would be guaranteed by zero-coupon US Treasury bonds which the defaulting nation would purchase with financing support from the IMF/World Bank.

The 1989 Brady Debt Reduction Plan

- Debtor countries:

1. Tough macroeconomic adjustment programs under the monitoring of the IMF
2. Cofinance LT debt repayment guarantees with purchase of zero-coupon bonds

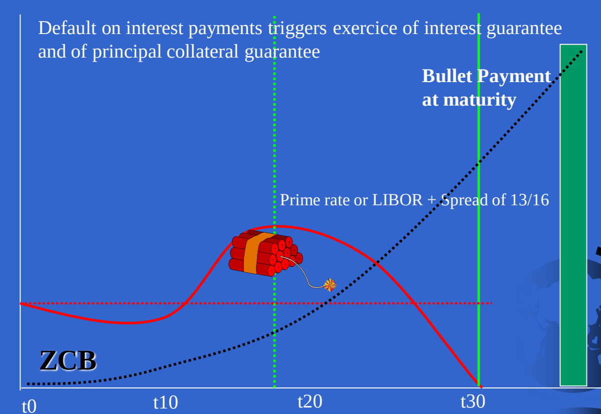
- London Club banks:

1. Provide deep discounts through interest or debt stock reduction
2. Get accounting and regulatory incentives

Brady Bonds

- Brady Bonds are named after former U.S. Treasury Secretary Nicholas Brady.
- Brady bonds have their principal guaranteed as well as x semi-annual interest payments, whose guarantee is rolled over.
- Bullet repayment is collateralized by 30-year zero coupon bonds, with a specific-purpose issue of the US Treasury, the Banque de France or the BIS.
- Cross-default clause

Brady Bonds



How to assess and calculate the market value of a collateralized Brady Bond?

- Brady bonds comprise defaulted London Club debt, repackaged and backed by 30-year US Treasury bonds as collateral, often including a rolling 18-month interest guarantee.
- 1. Strip the bond by separating the risk from the no-risk elements (interest and principal)
- 2. Calculate the risk-adjusted NPV of the guaranteed and non-guaranteed streams of interest payments and the principal payment at maturity

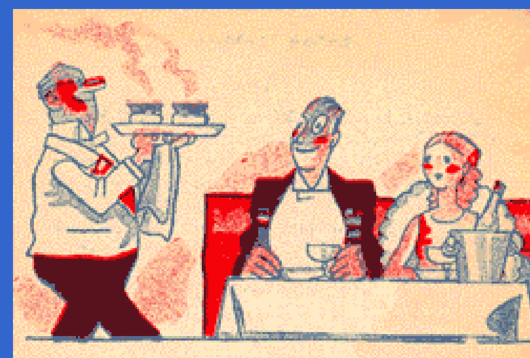
Brady Bonds

- In February 1990, Mexico became the first country to issue Bradys, converting $48.1 billion of its eligible foreign debt to commercial banks.
- US$200 bn of Bradys from 18 countries in Asia, Africa, Eastern Europe and Latin America
- Mexico, Brazil, Venezuela & Argentina account for more than 2/3 of Brady Bonds issued.

Brady Bonds

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

The Brady Plan = Menu-based debt restructuring



New Rationale

1. Convincing banks to write down a portion of their exposure in order to maintain the quality of remaining assets.

2. Imposing structural reform programs in the debtor countries, geared towards market-based economic policies: trade liberalization, exchange rate adjustment, privatization, and public sector reform.

Objective

Achieving net reduction in debt and debt service that is compatible with the countries' long-term growth requirements. Debt relief would be expected to reduce the uncertainty associated with debt overhang and, thus, encouraging domestic investment + FDI.

Market-driven menu of options:

⇔ **new money loans + discounted buybacks + exit bonds + debt conversion + debt restructuring bonds**

⇔ **Official Support: up to US$ 25 billion to support the Brady initiative from the IMF + World Bank + RDB + OECD creditors:**

Types of Brady Bonds

- **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 Generally principal is collateralized 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.

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 in their 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.

Menu of Debt Restructuring Instruments

* Par Bond: Exchange of old claims for a bond with the same face value but a below market interest rate and, generally, a bullet maturity of 30 years.

* Discount Bond: Conversion of old claims into a bond with a discounted face value (negotiated by debtors and creditors) and offering a floating market-based rate of interest. Bullet maturity <= 30 years.

* Front-Loaded Interest Reduction Bond (FLIRBs): Exchange of old claims for a bond with the same face value and a below market rate of interest reflecting a comparable credit risk for the first few years, increasing gradually, generally to a market-based rate.

* Debt Conversion Bond: Exchange of old claims for a bond with an option to convert into domestic equity or in local-currency denominated assets.

* New Money Bonds: Purchases of new instruments with a variable rate of interest, usually a spread over LIBOR. Maturities of 10 to 15 years.

Par, Discount and FLIRB bonds:

- may have principal collateralization, usually 30 year U.S. Treasury zero-coupon bonds, and/or rolling interest collateralization (usually 12-18 months);

- may be excluded from further new money requests of the bond issuer in order to maintain the implicit seniority of the new debt;

- may be eligible for debt-equity conversions in the developing country. In some cases, the bonds carry rights to receive additional payments that are triggered by an increase in the price of the country's major exportable goods. The value recovery clause can be linked to the evolution of GDP, an index of terms of trade, or export receipts.

Bank Options in Debt Restructuring Menus

BANKS	MEXICO			PHILIPPINES	
	Par Bonds	Discount Bonds	New Money	Buybacks	New Money
Canada	48%	52%	0%	100%	0%
France	79%	9%	12%	4%	96%
Germany	80%	20%	0%	81%	19%
Japan	18%	81%	0%	41%	59%
United Kingdor	48%	45%	6%	54%	46%
United States	58%	24%	19%	18%	82%

Bank Menu Choices in Brady Agreements

	Par Bonds	Discount Bonds	Buybacks
Argentina	66	34	
Bolivia	19	35	46
Brazil	32	35	
Bulgaria		60	13
Costa Rica			63
Dom. Republic		65	35
Ecuador	42	58	

COTE d 'IVOIRE-Debt Restructuring

Debt Stock	US $ 7.2 billion o/w 4.4 int. Arrears. Redenomination in FF/US$
Upfront costs & Enhancements	NPV Debt reduction = about 78.5%. Costs about = US $ 287 million incl. US $ 60 m. from RCI.
New Money	No, menu includes discounted debt buyback, par and discount bonds and conversion.
Buyback	30% of principal at 24 cents mandatory minimum cancellation of past due interest payments. Cost= US$190 million
Discount bonds	Discount= 35%. 30 year bond in FF and US $ denominations Collateral on Principal only. Agents: US Fed, Bdf, BIS. During first ten years, rates to rise from 2.5% in 98 to 4% in 2008. Cost of collateral= US$90 million
Par Bonds	20 year bond with low int. rates (2% in Y1) until year 13 and L+13/16 thereafter in FF and US $ denominations. Rolling interest guarantee until end of year 13. Repayments due in 2006-2016. No collateral on principal.

COTE d 'IVOIRE-Debt Restructuring (end)

PDI bonds	Base=First generation only with L-200 bp (US$955 m). US $ 30 million cash payment at closing. Rising rates from 2% to L+13/16% on Y 16. 20 year notes with value recovery.
Debt Conversion Bonds	bonds eligible for debt conversion
Rescheduling	No
Waivers	Yes
Bank Legal Advisor	White and Case
Country Advisor	Lazard/SBC Warburg/Cleary
Steering Com. Chair	BNP (Citibank, Crédit Lyonnais)

September-October 1999: The debt default of Ecuador occupies the limelight

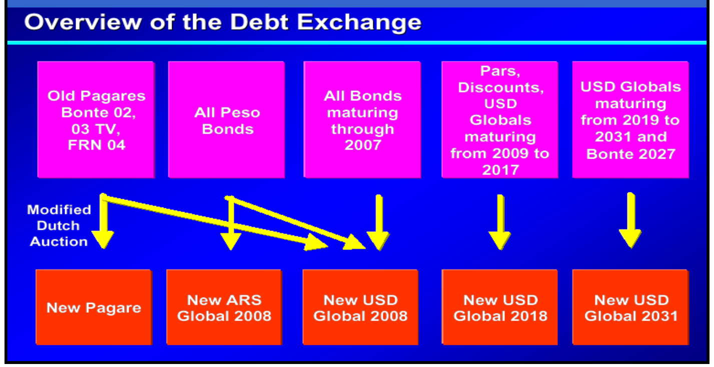
- Ecuador: Brady bonds account for US$6.1 billion in Ecuador's overall external indebtedness of US$13 billion. The Brady bonds have been subject to a lot of financial engineering, including the stripping of the collateral out of the bonds.
- IMF's position: Ecuador needs to find out some US$500 million to cover its balance of payments shortfall until the end of next year, and about US$1 billion to cover its budget shortfall, and probably more since Ecuador has foreign currency denominated domestic debt.... For the first time in 55 years, the IMF is acquiescing in a country's decision to default on its debts to the international bond markets.

The case of Argentina

- Argentina has spent more than a quarter of its history since 1824 either defaulting on its debt or restructuring it.
- The default at the end of 2001 followed those of 1989, 1982, 1890 and 1828. Each time investors returned, albeit at a heavy price.
- In 2005, Argentina opened a ***Museo de la Deuda*** en Buenos Aires…

Voluntary Debt Restructuring - Swaps

- May 2001 Argentina offered ≈ \$30 bn debt swap
  - in exchange for old securities it issues four NEW GLOBAL BONDS and a NEW PAGARE

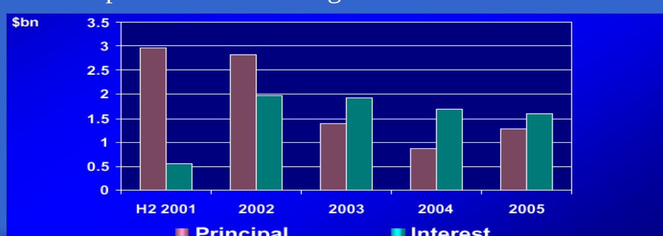


Voluntary Debt Restructuring - Swaps

- Argentina's local banks, insurance companies and pension funds (that hold at least a third of Argentina's \$95bn bonds) have swapped more than \$55bn in federal government debt for new obligations that carry lower interest rate over a longer period
- The operation has reduced Argentina's debt service cost by \$3.5bn per year

Voluntary Debt Restructuring - Swaps

- 12/04 Argentina offered to swap another \$60bn in locally owned bonds; the new bonds are backed by futures tax revenues and will pay a maximum of 7%
- Argentina hopes that voluntary exchange of local debt will be followed by similar foreign debt exchange => reduce pressure on its budget



The case of Argentina

- European banks' initiative: to bring together European bondholders of Argentina's Treasury bonds to weight in the negotiations with Argentina
- Amount of Argentinean bonds: €10 billion
- Italy is the most concerned with nearly 200,000 bondholders
- Bondholders are required to accept a 66% haircut!

Argentina in 12/2004

Argentina began debt restucturing road shows with a 70% NPV debt reductio request: MENU

- Small investors, whose plight attracts the most sympathy in Rome, Berlin and Tokyo, will be offered "**par" bonds**. Denominated in dollars, these will carry the same face value as the bad debts they replace, but will not mature until **2038**, paying a low rate of interest in the meantime.
- Domestic pension funds will swap their defunct dollar IOUs for a limited number of **peso bonds**, worth 30.1% less at face value, paying 3.31% interest, and maturing four decades hence.
- Argentina's biggest foreign creditors will get "**discount" bonds**, knocking 66.3% off the face value of the bonds they replace, and will not mature for almost 30 years.

Argentina in 12/2004

- To sweeten the deal, Argentina acknowledged the $2.1 billion in interest that went unpaid before 12/2001—but not the more than $20 billion of interest that has accumulated since. It will also backdate the new bonds to 12/2003, so that an interest payment of about $475m will fall due immediately. Extra money will be set aside for bondholders if Argentina grows faster than 3% per year from now on.
- The true extent of the haircut may not be clear until the new bonds first come on the market. But they are unlikely to be worth much more than 30% of the original value of the bonds they replace.
- By comparison, Ecuador offered creditors between 33% and 62% after its default in October 1999. Russia offered 35% after its 1998 default.

Argentina's debt default

- 12/2004: Argentina's delays in restructuring about $100 billion of defaulted bonds reduced the country's foreign reserves and prevented a resumption of loan negotiations with the IMF.
- The IMF suspended in 08/04 a $13.3 billion loan accord to Argentina until the country reaches an agreement with creditors on the bonds it defaulted on in late 2001
- June 2005: completion of LC Debt restructuring

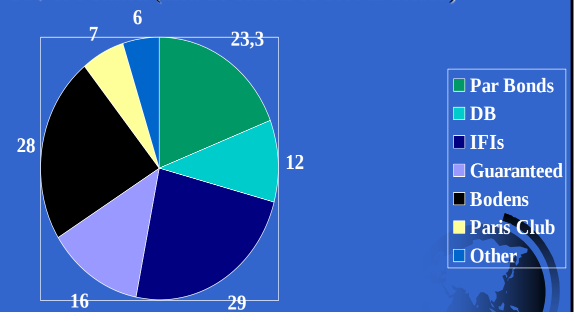
The June 2005 Deal!

- Argentina exchanged US$62 billion of old debt in default for US$35 billion of new long-term bonds, with US$20 billion remaining in default due to non-participation
- Result: a decline in total debt from US$191 billion *ex ante* to US$140 billion *ex post= decline in NPV by 67%*

Argentina's public debt as of 2006

(post restructuring) in billions of US$

Total debt= US$ 131 billion (incl. 20 billion of debt in default)



Source: IIF and IMF

Argentina's debt outstanding as of 2006

External Debt and Debt Service

	2004	2005	2006f	2007f
	(billions of dollars)			
External debt	174.7	137.0	131.1	134.0
% GDP	114.1	75.2	64.2	56.0
% exports[1]	404.5	274.0	239.3	222.8
Medium-/long-term	133.6	94.7	88.2	90.9
Short-term	14.9	14.5	14.8	15.1
International financial institutions	32.8	27.4	17.1	16.5
Official bilateral creditors	7.7	8.7	9.6	10.3
Commercial banks	13.6	13.0	13.2	13.4
Other private creditors	120.6	88.0	91.1	93.8
Reserves excluding gold	19.6	28.1	29.8	33.0
Months of imports[1]	5.9	7.5	7.3	7.4
	(percent exports)[1]			
Debt service	44.6	26.0	35.8	15.3
Interest payments due	22.6	13.1	10.2	8.1
Amortization paid	22.0	12.9	25.5	7.2

f = IIF forecast

[1] Goods, services and income.

New Ball Game 1997/2000: Brady Debt Exchange Offers

- Enhanced liability management gives rise to debt exchanges:
- 1997: Brazil: US$4 billion Bradys for new 30-year global bond
- 1997: Argentina: US$2.3 billion Bradys for new 30-year global
- 1997: Venezuela: US$4 billion Brady exchange
- 1997: Panama: US$0.7 billion Brady exchange
- 1999: Philippines: US$1 billion Bradys for new 10-year bond
- 1999: Brazil: US$2 billion Pars, Flirbs, NMBs for new 10- year bond
- 2000: Argentina: US$2.4 billion Pars, Discounts, FRBs for new 15-year global bond
- 2000: Brazil: US$5.2 billion Bradys for new global bond
- 2000: Ecuador: Eurobonds and Bradys for new 12-year and 30-year global bonds

Eurobond investors

- December 2000: Eurobond investors in Emerging Markets debt set up an advisory and advocacy group to win a place at the negotiating table with sovereign debtors!
- Seven founding members of the **Emerging Markets Creditors Association (EMCA)** to represent buy-side interest to the IMF and the WB.
- 2003: Argentina's bondholders get organized

Secondary market trading, discounted debt purchases and « *vulture* » funds

- 2000-2007: increasing securitization of commercial bank' claims, opening the way to purchases by non-bank financial institutions, including investment funds
- 2006-07:growing number of investment funds launching legal action against debtor countries in NY, London and Paris courts
- Most funds are based in Virgin islands: Donegal International, Debt Advisory International, Walker International, Elliott Associates, Kensington International…

Vulture funds in action

1. "VULTURE FUNDS" – COMPANIES THAT, « PREY » ON POOR COUNTRIES BY BUYING UP DEFAULTED DEBT AND SEEKING FULL PAYMENT.
2. TRADITIONAL TACTIC : TO BUY DEFAULTED DEBT AT A DISCOUNT, REFUSE TO PARTICIPATE IN ANY GENERAL RESTRUCTURING WHERE THE VALUE OF THE DEBT IS WRITTEN DOWN, AND SUE FOR A HIGHER PAYBACK.
3. ELLIOTT ASSOCIATES, A NY-BASED INVESTMENT FUND, FORCED PAYMENT OF $55M FROM PERU IN 2000. A COUNTRY DESPERATE TO REGAIN RESPECTABILITY AND BORROW AGAIN FROM INTERNATIONAL CAPITAL MARKETS HAS A STRONG INCENTIVE TO PAY OFF A MINORITY OF LITIGIOUS BONDHOLDERS FOR A QUIET LIFE.
4. ELLIOTT'S CREATIVE LEGAL MOVE IN THE PERU CASE WAS TO ARGUE THAT PERU WAS IGNORING SO-CALLED **PARI PASSU CLAUSES** IN BOND CONTRACTS, WHICH HOLD THAT ALL CREDITORS SHOULD BE TREATED EQUALLY. A BRUSSELS COURT AGREED, AND RATHER THAN APPEAL PERU PAID UP. BUT SINCE THEN BELGIAN LAW HAS BEEN CHANGED TO PREVENT A REPETITION, AND THE US ADMINISTRATION HAS WEIGHED IN TO THE ISSUE, ARGUING AGAINST THIS INTERPRETATION OF PARI PASSU UNDER NEW YORK BOND LAW.
5. NEW YORK LAW WAS ALSO CHANGED IN 2003 TO ALLOW "COLLECTIVE ACTION CLAUSES" IN BONDS. LONG A FEATURE OF ENGLISH LAW, THE CLAUSES ALLOW A MAJORITY OF CREDITORS TO OVERRULE A MINORITY HOLDOUT.

FT February 18, 2007

Vulture funds and discounted debt

- Legal actions against Cameroon, Zambia, Congo, Peru, Nicaragua…