

4th Inter-regional Debt Management Conference, UNCTAD

Collective Action Clauses

Summary of discussion

Tuesday, 11 November 2003

Presentation: Mr Robert Gray and Clifford Dammers, International Primary Market Association (IPMA)

Representing the International Primary Market Association (IPMA), the speakers pointed out that IPMA recognises that the introduction of collective action clauses (CACs) into loan and bond contracts is an essential step forward in bringing sovereign debt crises to a quick resolution. IPMA strongly favours the standardization of market practice in the use of CACs, and that this would contribute to a more orderly and efficient market for emerging countries financing. Contrarily to the IMF's Sovereign Debt Restructuring Mechanism, which proposed a statutory approach premised on aggregation of all claims, IPMA favours the market based approach, which is also preferred by issuers.

Recognising that the problem of creditor coordination has become more acute since the 1980s because of the more widespread use of bonds in emerging market financing, bondholders depend on the power of IPMA and other trade associations to enforce their claims against sovereign governments. By ensuring transparency in the sense that all creditors are being treated fairly in relation to other creditors, they are likely to cooperate and in the cases where a majority of creditors cannot be achieved, exchange offers is an alternative market based remedy. IPMA recognises that the aggregation of multiple bond issues for voting purposes, as advocated by the IMF's SDRM proposal, can be effective in eroding the power of rogue creditors. However, it questions if the benefits of aggregation outweigh the demerit of direct interference in contractual rights and if there is a proven need for aggregation. IPMA gave evidence of major bond restructurings that took place, mostly using exchange offers, without being obstructed by rogue creditors. Rating agencies have not made distinctions between bonds issued under different governing laws, using or not CACs. Qualified majority voting is also good for the debtor as it reduced the incentive for any bondholder to seek an individual settlement and reduces a rogue creditor's ability to hold to ransom a reasonable debt settlement. The key issue is to institutionalise the principle of CACs to make creditor coordination more efficient and effective.

The so-called Gang of Six trade associations set up a working group on the standardization of CACs, which produced a first proposal in January 2003 that included four provisions to be included in CACs:

- *Majority action*: Defines the necessary majority to amend bonds' economic and financial terms;
- *Engagement Clause*: Bondholders' committee representing the bondholders formed on request of issuer requesting restructuring;

- *Initiation Clause*: Provides for the suspension of payments up to the formation of the bondholders' committee and prevents initiation of litigations during this period;
- *Transparency Provisions*: Enforces the issuer to comply with standard data publication guidelines such as the Special Data Dissemination Standards and to disseminate transparent information on its debt.

Proposals submitted to cooperate with the G10's own working group on the standardization of CACs were not accepted. Since Mexico's major issue in February 2003 under New York law and including CACs, with no evidence of higher yields, which was then followed by other countries, the argument over using or not CACs has been settled and work on their standardization will proceed, using the Mexican example and dropping most probably the transparency provision. Adoption of CACs by issuer should be achieved without financial incentives offered by the official sector, as this sends a strong signal that issuers are undertaking something that is not in their interest.