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Collective Action Clauses (CACS): an analysis of provisions included in recent sovereign bond issues

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I Background

IN 1995, IN THE WAKE OF THE MEXICAN CRISIS, the Ministers and Governors of the G10 countries[1] established a working party to consider the complex set of issues arising with respect to the orderly resolution of sovereign debt crises. The Working Party, chaired by Jean-Jacques Rey of the National Bank of Belgium, focused its attention on those forms of debt to private creditors, such as internationally traded securities, that had increased in importance in the preceding few years but had generally been shielded from payments suspensions or restructuring during the 1980s debt crises.[2] The Rey Group concluded, *inter alia* that incorporating clauses into sovereign bond contracts that would (a) provide for the collective representation of debt holders in the event of a crisis, (b) allow for qualified majority voting to alter the terms and conditions of bond contracts, and (c) require the sharing among creditors of assets received from the debtor, could be helpful in facilitating the resolution of future sovereign debt crises.[3] Such provisions are known as 'Collective Action Clauses' (CACs).[4] The members of the Rey Group were also strongly of the view that the evolution of contractual arrangements between sovereign borrowers and their creditors needed to be a market-led process if it were to be successful. The Rey Report was published in May 1996, but little change in market practice followed.

During the following seven years there were a series of emerging market financial crises, a number of which led to sovereign bond restructurings.[5] The experience with some of these restructurings reinforced the consensus that the framework for restructuring sovereign bonds needed clarifying and improving. As part of that work, G10 Ministers and Governors asked a second working group – chaired by Randy Quarles of the US Treasury – to develop a set of model CACs for sovereign bond issues, with the aim of catalysing a change in market practice. The Working Group consulted closely with a group of eminent lawyers from the main jurisdictions (England, Germany, Japan and New York) under whose laws sovereigns issue bonds and developed a set of model clauses that, they believed built on existing market practices, promoted a consistent framework across jurisdictions and benefited the interests of both debtors and creditors.

The Working Group identified three interrelated objectives that they felt would make the process for restructuring sovereign bonds more orderly:

- to foster early dialogue, coordination, and communication among creditors and a sovereign caught up in a sovereign debt problem;
- to ensure that there are effective means for creditors and debtors to re-contract, without a minority of debt-holders obstructing the process; and
- to ensure that disruptive legal action by individual creditors does not hamper a workout that is under way, while protecting the interests of the creditor group.

The scope of the clauses the Working Group included in their recommendations was guided by these objectives.[6]

In parallel to the work undertaken by the G10, seven private sector trade associations developed their own 'model features' for CACs in sovereign bonds issued under both New York and English law.[7] The key features of the trade associations' proposals and how they compare with the G10's recommendations and with recent market practice are set out in Appendix B.

While collective action clauses have been widely used in sovereign bonds issued under English law

[1] The following eleven countries are the members of the G10: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States.

[2] The apparent seniority of traded securities was a comparatively recent phenomenon: prior to the Second World War, defaults on sovereign bond issues occurred with some regulatory.

[3] See http://www.bis.org/publ/gten03.pdf for a copy of the 1996 G10 Report on The Resolution of Sovereign Liquidity Crises.

[4] For further background on CACs, see http://www.bankofengland.co.uk/fsr/fsr08art8.pdf

[5] These included Russia (1998), Pakistan (1999), Ecuador (1999), Ukraine (2000), Moldova (2002), Uruguay (2003) and Argentina (still outstanding).

[6] The Report of the G-10 Working Group on Contractual Clauses was published in March 2003 and is available at: http://www.bis.org/publ/gten08.htm#pgtop

[7] The Institute of International Finance (IIF); the International Primary Market Association (IPMA); Emerging Markets Creditors Association (EMCA); Trade Association for the Emerging Markets (EMTA); the Securities Industry Association (SIA); the International Securities Market Association (ISMA); and the Bond Market Association (TBMA). See http://www.emta.org/ndevelop/Final_merged.pdf for their draft model clauses dated 31 January 2003.

for a long time, until February 2003 their use in sovereign bonds issued under New York law had been the exception rather than the rule. However, in February 2003, Mexico included majority amendment, disenfranchisement, acceleration and rescission of acceleration clauses in a new sovereign issue and, since then, the vast majority of sovereign bonds issued under New York law have included collective action clauses.

This paper[1] examines the clauses that have been included in foreign currency sovereign bonds issued since February 2003 and attempts a preliminary assessment of the extent to which the CACs they contain meet the three objectives set out in the Report of the G10 Working Group on Contractual Clauses: part II sets out some information on the changing proportion of foreign currency sovereign bonds that contain CACs; part III looks at which clauses have been incorporated in recent issues; part IV provides a preliminary assessment of the extent to which the CACs being used meet the G10's objectives; and part V provides some concluding remarks on further steps that could be helpful in developing a more orderly system for restructuring sovereign debt. The broad conclusions are that the second of the G10 objectives – effective means for creditors and debtors to re-contract (which the working group considered to be the most critical component of their recommendations) – has largely been achieved, but comparatively little progress has so far been made in respect of the other two objectives, of fostering dialogue, coordination and communication, and of avoiding disruptive legal action.

II Proportion of foreign currency sovereign debt issues with CACs

While, historically, CACs have been common in some jurisdictions where sovereign bonds are issued (like England, Luxembourg and Japan), prior to February 2003 they were relatively uncommon in sovereign bonds issued under New York law.[2] However, since Mexico's path-breaking issue, a significant number of emerging market countries have included CACs in new bonds issued in New York. These include Belize, Brazil, Chile, Colombia, Costa Rica, Guatemala, Indonesia, Korea, Mexico, Panama, Peru, the Philippines, Poland, South Africa, Turkey, Uruguay and Venezuela. Uruguay and the Philippines have also included CACs in the new bonds they have issued in exchange for outstanding bonds as part of arrangements to change the terms on some of their outstanding sovereign debt.

Among industrial countries, Italy has included CACs in bonds it has issued under New York law since June 2003. The Italian issues are consistent with the commitment made by the members of the European Union (EU) that sovereign bonds issued under foreign jurisdictions would aim to include CACs that reflected the G10 Working Group's recommendations.[3] The UK Government's US$3 billion 2.25% notes maturing in 2008 and the Bank of England Euro Notes maturing in 2007 also include such CACs, in the spirit of the G10's Report and the EU's common commitment, although they are issued under domestic English law.

Only a few sovereigns who have issued since February 2003 have not included CACs in their new issues under New York law.[4] While cost has sometimes been cited as a reason for caution about including CACs in bond issues, recent studies of the impact of including CACs on the pricing of sovereign bonds have not found any significant effect.[5]

Chart 1 and Table 1 show that during much of the past decade New York's share of the foreign currency sovereign bond market increased (although in the past few years London's share has

[1] We are grateful for the assistance provided in the preparation of this paper by colleagues at the IMF, the G10 Secretariat and the Banca d'Italia.

[2] There are some exceptions. Bulgaria, Egypt, Kazakhstan, Lebanon and Qatar all issued New York law bonds with majority amendment clauses prior to the recent initiative. See Richards and Gugiatti (2003), *Do Collective Action Clauses Influence Bond Yields? New Evidence from Emerging Markets*. International Finance 6:3, p. 421.

[3] The speech by the ECOFIN President to the IMFC in April 2003 stated that "the EU will use contractual provisions based on the framework developed by the G10, and where necessary in accordance with applicable law and adjusted to local legal practice, in their central government bonds issued under a foreign jurisdiction and/or governed by a foreign law by the end of this year. Thereafter, EU Member States will no longer issue such bonds without any CACs."

[4] China, Hong Kong, Israel and Jamaica (which re-opened an existing issue) have issued bonds in New York since February 2003 without CACs.

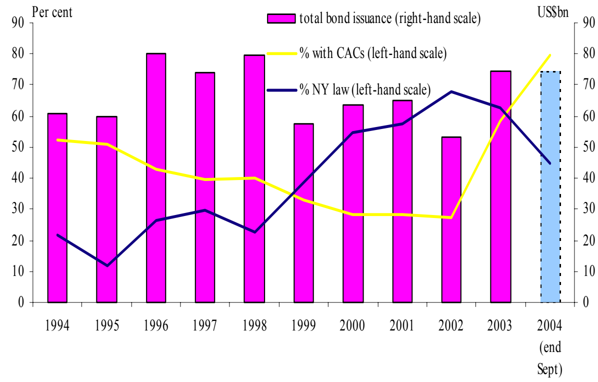
[5] See Richards and Gugiatti (2003) for recent findings and a review of earlier studies.

risen from the low point reached in 2000). Since very few issues made under New York law prior to 2003 included any CACs, the increased concentration of sovereign issues in New York meant that the proportion of all foreign currency sovereign bonds issued with CACs had been falling. However, this picture dramatically changed with the introduction of CACs in many issues made in New York in 2003.

Approximately 47% of sovereign bonds issued under New York law in 2003 included CACs (and 58% of all foreign currency sovereign bonds issued in 2003 included some form of CACs). In the first nine months of 2004, nearly all sovereign bonds issued in New York contained CACs (and the share of all foreign currency sovereign bonds issued in the first nine months of 2004 that contained CACs reached 80%). **Thus, it now appears that, in the space of just 19 months, the inclusion of CACs in sovereign bonds issued under New York law has switched from being the exception to becoming the market standard.**

As old bonds are redeemed this change in practice will mean that the proportion of the outstanding stock of foreign currency sovereign bonds that do contain CACs will steadily rise. Currently approximately 40% of the total outstanding stock of foreign currency sovereign bonds contain CACs.

Chart 1:
Foreign currency sovereign bond issuance with CACs[(a)]



Source: Dealogic Bondware

(a) Central government only

Table 1:
Foreign currency sovereign bond issuance by governing law 1994-2004 ($ billion)

Governing law	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004, to 30 Sept*
New York (with CACs)	13.1	7.1	21.3	22.0	18.0	22.2	34.7	37.2	36.3	46.7 (21.8)	33.4 (31.1)
English - with CACs	26.7	26.2	25.0	26.8	30.0	17.9	12.5	14.2	14.4	21.4	27.4
Italian	4.6	10.3	3.8	7.0	11.4	5.0	5.8	7.7	1.5	4.9	2.1
German	7.2	5.9	12.4	7.8	6.1	8.6	4.7	0.9	0.0	0.5	1.8
Japanese - with CACs	4.6	3.9	9.2	2.1	0.1	0.7	5.5	4.2	0.2	0.4	0.9
Swiss	0.2	1.2	1.2	0.7	1.4	0.1	0.6	0.4	0.1	0.4	1.6
Luxembourg - with CACs	0.3	0.3	0.1	0.5	1.7	0.3	0.0	0.0	0.0	0.0	0.0
Other *	3.9	4.8	7.2	7.3	10.8	2.5	0.0	0.4	1.0	0.4	7.2**
TOTAL	**60.7**	**59.9**	**80.3**	**74.1**	**79.6**	**57.4**	**63.7**	**64.9**	**53.4**	**74.7**	**74.4**
% of total with CACs	**52.1**	**50.8**	**42.7**	**39.6**	**40.0**	**33.0**	**28.1**	**28.2**	**27.3**	**58.4**	**79.8**
% of total issued under NY law	**21.7**	**11.9**	**26.6**	**29.7**	**22.6**	**38.7**	**54.4**	**57.3**	**67.9**	**62.5**	**44.9**

Source: Dealogic Bondware and IMF
* Other includes Austria, Canada, Colombia, Denmark, Finland, France, Greece, Korea, Netherlands, Portugal, Spain, and other US issues.
** Includes foreign currency issues by Denmark, Finland and Korea, and by some Canadian provinces and Crown corporations in their own legal jurisdictions.

III Comparison of CACs included in 2003/4 sovereign issues with the recommendations of the G10 Working Group

While all the recent sovereign issues made under New York law have included a majority amendment clause – which permits the amendment of payment terms with the approval of supermajority of bondholders – issuers have made more diverse choices over the inclusion of other possible clauses. The main features of the CACs included in a number of recent EME sovereign bond issues, are summarised in Table 2 and compared with the recommendations of the G10 Working Group (a more detailed comparison is provided in Appendix A). Where the wording of clauses appears to have been more influenced by the draft model clauses published by the group of seven private sector trade associations, this is also noted. The focus is largely on bonds issued under New York law, as this is the jurisdiction where market practice has been changing most significantly.

Majority amendment clause: voting threshold and subjects to be covered

Most issuers have chosen a threshold of 75% of principal outstanding for *votes on reserved matters* (such as payment terms), which is consistent with the recommendation of the G10 Working Group. A number of early sub-investment-grade issuers (Brazil, Belize, Guatemala and Venezuela) chose a higher 85% threshold[1], leading some commentators to suggest that sub-investment-grade issuers would need to choose a higher threshold to signal greater commitment to avoiding future restructurings. This higher threshold may also have been influenced by the recommendations of the seven private sector trade associations. But the subsequent inclusion of CACs with a 75% threshold by Colombia, Costa Rica, Indonesia, Panama, Peru, the Philippines and Turkey – all sub-investment-grade issuers – suggests that the distinction between investment and non-investment-grade countries in the design of CACs is becoming more blurred and that issuers are increasingly aligning the threshold chosen for majority amendment clauses with the G10's recommendation. This trend was further reinforced in April 2004 when the Central Bank of Brazil announced that it would lower the threshold for the majority amendment provisions for its future issues under New York law from 85% to 75%.[2]

There has been some variation in issuers' *choice of reserved matters*.[3] While the list of reserved matters in most bonds is consistent with the list recommended by the G10, most issues do not use a trustee[4] or an alternative structure to represent bondholders on a collective basis (this is discussed further below). They also do not include the recommendation requiring a 75% vote to allow a supermajority of bondholders to accept an exchange offer, which, if approved, would then apply to all bondholders, as a reserved matter. It appears that the list of reserved matters may also have been influenced by the trade associations' proposals, since most bonds include additional terms – such as changes to the governing law, jurisdiction, status/*pari passu* ranking, and events of default – that were included in the trade associations' recommendations, but not in those of the G10. However, the voting thresholds set for reserved matters have generally been set at levels lower than those recommended by the trade associations.

There has been greater consistency in the voting provisions for *non-reserved matters*, (ie all the other matters covered in a bond issue that are not classified as reserved matters), with nearly all issuers having used a 66⅔% majority, as recommended by the G10 (Chile is an exception, with a 50% vote required for non-reserved matters).

The recommendation on the use of *disenfranchisement provisions*, which exclude from

[1] No issuers have included the most stringent of the trade associations' proposals, which called for unanimity for select matters, or allowing a 10% blocking minority to prevent an amendment. (Further background on the differences between the proposals put forward by the G10 and the seven private sector trade associations is provided in Appendix B.)

[2] Brazil followed through on this announcement when the threshold was set at 75% in the $750million Floating Rate Note issued in June 2004. However, as recently as 29 September, Venezuela made a $1.5 billion issue with the majority amendment threshold set at 85%.

[3] See the third page of appendix A for a list of the issues the G10 Working Group recommended should be treated as Reserve Matters.

[4] Most bonds issued under New York law include a fiscal agent who acts on behalf of the issuer, but do not include a trustee (or an elected bondholder representative) to act on behalf of bondholders collectively. See page 145 of the June 2000 *Financial Stability Review* for a fuller explanation of the role of trustees: this can be found at www.bankofengland.co.uk/fsr/fsr08art8.pdf

voting and quorum purposes those bonds owned or controlled directly or indirectly by the issuer or its public sector instrumentalities, appears to have been widely adopted, though there has been some variation in the formulation (see page 9).

Majority enforcement – acceleration

Another feature recommended by the G10, and adopted by the market, is the inclusion of a 25% threshold for *acceleration in the event of default*.[1] This provides a first line of defence against individual bondholder enforcement after default, since at least 25% of bondholders must agree to acceleration before any further legal claims can be taken forward.[2]

Most issuers have also included provisions for the *rescission of acceleration* with thresholds of either 66⅔% or 50%. This accords with the G10 report, which recommended "a majority, or a super majority" with a maximum of 66⅔% for rescission of acceleration.

Majority enforcement – litigation

The G10 Working Group recommended a set of provisions designed to restrict the ability of individual bondholders to initiate disruptive litigation. These included the use of a permanent *bondholders' representative* (a trustee or alternative) with the sole power to initiate litigation on behalf of all bondholders. The *pro rata* distribution of any litigation proceeds by the representative would provide a further disincentive to individual legal action.

However, only two issuers under New York law, Uruguay and Indonesia, have so far chosen to include these provisions (a trust indenture) in their bonds. Other issuers have continued to follow the New York market custom, ie a fiscal agency agreement, where the fiscal agent is the agent of the issuer – not of bondholders – and there are no restrictions on individual action. This was also the preferred approach of the seven trade associations, as there has been reluctance by some market participants to accept restrictions to their right to sue in respect of New York law instruments. However, trust provisions are fairly common under English law, and the trade associations' proposals contained model clauses including a trustee for English law bonds.[3]

Meetings and representation of bondholders

In line with the G10 recommendations most issuers have included provisions that allow *meetings* to be called at the request of 10% of bondholders. In some cases, including Brazil, Belize and Panama, this is restricted to meetings in the event of default.

While a few issues have incorporated provisions for election of *a representative to negotiate on behalf of bondholders* (eg the UK US Dollar bond issued in July 2003 under English law; and Hungary and Latvia's 2004 issues, also under English law, include provisions for the appointment of a bondholders' representative or committee in the event of certain events occurring – see footnote 1, page 8), this has been the exception rather than the rule. Hence, in the majority of issues the G10's recommendations on this subject have not been followed.[4] Instead, a number of issues – including those made by Mexico and Italy in 2003 – include provisions under which the fiscal agent is allowed to call and conduct a bondholders' meeting. On the request of at least 10% of the holders of the outstanding principal, the fiscal agent may convene a bondholders' meeting and conduct it. Subject to the affirmative vote of holders of not less than 75% (reserved matters), or 66⅔% (non-reserved matters), the fiscal agent may discuss modifying the terms of the bonds with the issuer.

Information provisions

The G10 Working Group recommended that a covenant be added to sovereign bonds that would require the sovereign to provide "certain types[5] of

[1] The G10 did not make any recommendations for what might constitute an event of default, and the actual terms vary across bond documentation.

[2] A potential minor addition to the existing acceleration provisions could be to specify that individuals can act if the fiscal agent (or trustee or alternative as applicable) fails to respond to the request of at least 25% of bondholders within a certain number of days. This would mirror the terms of the G10 recommendations for litigation.

[3] EMCA and EMTA did not endorse the documentation proposed by the trade associations for use under English law, as they objected to any sharing mechanism that 'unduly restricts the right of individual bondholder action'.

[4] The trade associations recommended a comparable 'engagement clause' that would apply in cases of default or restructurings: 50% of creditors could elect a committee to represent them in negotiations, and could hire advisors whose costs would be met by the issuer.

[5] The members of the Group acknowledged that further consideration would need to be given to the type of information to be provided, particularly as to the types of non-public information that could be provided that would not require confidentiality agreements.

information to its bondholders over the life of the bond and additional information following an event of default". While the members of the Working Group felt that such a covenant would encourage the public dissemination of key financial information in a timely manner, to date only Uruguay's new bonds, issued as part of its exchange offer, have included such provisions and these only apply in the event that Uruguay proposes a modification to any reserved matter.

Table 2: CACS in some recent sovereign bond issues–comparison with the G10 recommendations

G10 recommendation	Mexico	Uruguay	Brazil	Belize	South Africa	Turkey	Poland	Korea	Italy	Colombia	Panama	Chile	Venezuela	UK[1]
Governing law	NY	NY	NY	NY	NY	NY	NY	NY	NY	NY	NY	NY	NY	Eng-lish
Permanent bondholders' representative	Different	Same	Different	Different	Different	Different	Different	Different	Different	Different	Different	Different	Different	Same
Bondholders' negotiating representative with 66⅔% vote	Different	Different	Different	Different	Different	Different	Different	Different	Different	Different	Different	Different	Different	Same
Bondholders' meeting on request of 10% of bondholders	Same	Same	Partial	Partial	Same	Same	Same	Same	Same	Same	Partial	Same	Partial	Same
Majority action on reserved matters with 75% vote	Same	Same	Different	Different	Same	Same	Same	Same	Same	Same	Same	Same	Different	Same
List of reserved matters	Same *	Same *	Same *	Same *	Same *	Same *	Same *	Same *	Same *	Same *	Same *	Same *	Same *	Same *
Majority action on non-reserved matters with 66⅔% vote	Same	Same *	Same	Same	Same	Same	Same	Same	Same	Same	Same	Partial	Same	Same
Acceleration requires support of 25% of bondholders	Same	Same *	Same	Same	Same	Same	Partial	Same	Same	Same	Same	Same	Same	Same *
Rescission of acceleration by 66⅔% of bondholders	Same *	Same	Same	Different	Same *	Same	Partial	Same *	Same	Same *	Same	Same *	Same *	Same *
Litigation to be instituted solely by the permanent representative	Different	Same	Different	Different	Different	Different	Different	Different	Different	Different	Different	Different	Different	Same
Majority action on continuation and outcome of litigation	Different	Different	Different	Different	Different	Different	Different	Different	Different	Different	Different	Different	Different	Same *
Distribution of proceeds *pro rata*	Different	Same	Different	Different	Different	Different	Different	Different	Different	Different	Different	Different	Different	Same
Disenfranchisement provision	Same	Same *	Same	Different	Same	Same	Same	Same	Same *	Same	Same	Same	Same	Same
Information provision – to be included on a case-by-case basis	Different	Same *	Different	Different	Different	Different	Different	Different	Different	Different	Different	Different	Different	Different

(green)	Same as G10 recommendations in substance
(red)	Different from G10 recommendations
(amber)	Partial implementation of G10 recommendations
*	Some smaller variation

[1] The recommendations of the G10 Report were directed at bonds "issued by a sovereign and governed by the laws of a jurisdiction other than the sovereign". The UK issue does not strictly fit this definition since, although it was issued in a foreign currency, it was issued in the local jurisdiction.

IV Preliminary assessment

This section considers the extent to which recent issues with CACs may have met the three objectives identified by the members of the Working Group on Contractual Clauses (see paragraph 3). While the evolving market standard has differed from the G10 recommendations in some respects, these changes may reflect innovations, and some objectives may have been met through other means. On the other hand, certain omissions might weaken the efficacy of the clauses. Since there has not yet been a crisis 'test case' to evaluate whether recent CACs are successful in promoting more orderly debt restructurings, this initial assessment of the extent to which the G10's key objectives are being met cannot be definitive. But, the Uruguay exchange offer and the Argentine default may provide some useful pointers as to which provisions could be useful in achieving more orderly debt restructurings.

Fostering early dialogue, coordination, and communication between creditors and sovereigns

The Working Group recommended four provisions to achieve the objective of fostering early dialogue, co-ordination and communication:

a. a permanent bondholders' representative to act as an interlocutor with the sovereign [generally not adopted];

b. a mechanism for the election of a special bondholders' representative empowered to engage in restructuring discussions with the debtor [generally not adopted];

c. provisions for bondholders, the issuer or a representative, to call a meeting of bondholders [generally adopted]; and

d. information covenants requiring the sovereign to provide certain types of information over the life of the bond and additional information following an event of default [generally not adopted].

Most of the G10 recommendations aimed at meeting this objective are yet to be taken up: only provisions for meetings, (c), have been included in most recent issues.[1]

Bondholder representation (a) and (b). Recent experience with debt restructurings in Uruguay and Argentina highlights the diversity of circumstances that can arise. Uruguay's successful voluntary exchange offer involved frequent discussions between the sovereign and bondholders. In this case, there was no obvious need for further legal provisions for bondholder representation. By contrast, the long hiatus between Argentina's default in December 2001 and the beginning of any formal process to restructure its debts raises the question whether the inclusion of contractual provisions for the election of a negotiating representative empowered by bondholders would have prompted an earlier start to negotiations.[2] However, it is also worth noting that Argentina's case is particularly challenging because of the diversity of instruments to be restructured. In these circumstances, provisions for representation applying to a single instrument may not be sufficient to address wider issues of creditor representation and coordination with the sovereign (see below for a discussion of aggregation issues).

Information provisions (d). With the exception of Uruguay, these have not been adopted in recent CACs. However, both the official sector and the Institute for International Finance have been active in encouraging greater transparency through a number of initiatives (eg the IMF's Special Data Dissemination Standard, Reports on the Observance of Standards and Codes, and Investor Relations Programmes[3]).

There may, however, be alternative ways of meeting the objectives of bondholder representation and

[1] There are at least four exceptions. Both Uruguay's new bonds resulting from the May 2003 voluntary debt exchange, and Indonesia's $1 billion issue launched in March 2004, were made under trust deeds under New York law, where the trustee acts as a permanent representative. Hungary's January 2004 €1billion issue and Latvia's March 2004 €400 million issue, use fiscal agents under English law, and allow bondholders with more than 50% of principal outstanding to appoint any person or a committee to represent their interests in the event of a default or if a restructuring is publicly announced.

[2] In principle, a sovereign should accept that an agent elected in accordance with provisions in its bond documentation is representative of bondholders, and should engage in discussions with that agent consistent with the IMF's lending into arrears policy which requires sovereigns to negotiate with its creditors in good faith.

[3] Information on all three initiatives can be found on the IMF website: http://www.imf.org

information provisions. One possibility is the drafting of a voluntary code of conduct (or a set of principles) for debt restructuring developed through a process of dialogue between representatives of the private sector and some of the main issuers of sovereign debt.

Ensuring effective means for creditors and debtors to re-contract without a minority of debt holders obstructing the process

The Working Group recommended a number of provisions to achieve this objective:

a. a majority amendment clause [adopted];

b. disenfranchisement provisions to avoid manipulation of votes by the sovereign [adopted], and

c. a reserved matter enabling a supermajority of bondholders to accept an exchange offer [not adopted to date].

d. In addition, although it was not included as a specific recommendation, the Group also noted that aggregation clauses could be useful [generally not adopted].

All the bonds issued with some CACs in the past 19 months have included a majority amendment clause, (a). This is the key clause for meeting the re-contracting objective because it reduces the threat of hold-out creditors preventing restructurings. Members of the G10 Working Group considered it to be the most critical component of their package of proposals. In addition to a majority amendment clause, disenfranchisement clauses (b) - which exclude bonds held by the sovereign from voting - have also been widely adopted. However, the other recommendations aimed at smoothing recontracting - facilitating exchange offers, (c), and aggregation clauses, (d), - have generally not been adopted.[1]

While *disenfranchisement provisions, (b),* have been widely adopted, there has been some variation in the language used. Some issues introduce the concept of 'direct and indirect control', which is in line with the G10 report, but others only refer to 'direct and indirect' ownership which is a less broad concept. Also, while the G10 report refers to 'public sector instrumentalities', some of the issues use narrower terms such as 'an entity over which the government exercises control'.[2]

Wider *anti-manipulation features* were included in the bonds issued in Uruguay's debt exchange in order to provide investors with added reassurance. For example, the new bonds require Uruguay to certify the details of any holdings it has to enable bondholders to monitor and enforce the disenfranchisement provision. In addition, the trust indenture specifies that Uruguay will not issue new securities (or reopen any existing series of bonds) with the intention of placing them in the hands of investors expected to vote in support of a proposed modification. These innovations were well received by investors and raises the question whether other issuers would also find it beneficial to include similar anti-manipulation provisions in future sovereign issues.

Exchange offer, (c). The G10 Working Group proposed that a provision be included to allow a supermajority of bondholders (75% of the principal outstanding) to accept an exchange of existing bonds for new debt instruments as an alternative to amending existing bonds. Exchange offers have been the predominant method by which sovereign bonds have been restructured in recent years and such a provision would enable a supermajority of bondholders to make an exchange offer mandatory for all holders, thus facilitating the smooth completion of exchange offers.[3] However, so far, this provision has not been included by any sovereign issuers and there is a view that it may be possible to achieve the same result by using majority amendment clauses as a mechanism for

[1] The one exception is Uruguay's new bonds which include aggregation clauses and terms facilitating exchange offers.

[2] For example, a central bank is a public sector instrumentality, but in many countries is not under the direct control of the government.

[3] Exchange offers give sovereigns the opportunity to consolidate their outstanding debt in to a simpler portfolio with a smaller number of outstanding more liquid instruments. Details of recent successful exchange offers can be found in the following IMF documents: *Involving the Private Sector in the Resolution of Financial Crises – Restructuring International Sovereign Bonds of 11 January 2001; and Reviewing the Process for Sovereign Debt Restructuring within the Existing Legal Framework of 1 August 2003.* These can be found at www.imf.org/external/pubs/ft/series/03/ips.pdf and www.imf.org/external/np/pdr/sdrm/2003/080103.pdf .

consolidating outstanding debts into a smaller number of more liquid instruments.

In a limited number of cases – notably Ecuador – where the sovereign wanted to achieve an exchange but the bonds to be exchanged did not contain CACs, *exit consents* have been used as a means of minimising the threat of 'hold-out' creditors (see box).

However, exit consents are seen by many as a coercive tool and have therefore proved unpopular with many private creditors. Thus, contractual clauses - which provide the means for bondholders to accept an exchange offer (providing it is agreed by a supermajority of them) - may, in time, come to be a useful building block in constructing a more orderly regime for restructuring sovereign debt.

Box 1: Exit consents in bond exchanges

Exit consents (also known as 'exit amendments') are used as a technique to encourage full creditor participation in a bond exchange where the original international sovereign bonds are governed by New York law and do not contain majority restructuring provisions for payment terms. While bonds issued under New York law without CACs typically require unanimity to modify payment terms, they do permit other bond provisions – such as the waiver of sovereign immunity, submission to jurisdiction, financial covenants and listing – to be modified by a simple majority (with the issuers consent). The purpose of exit consents is to make a bond less attractive by modifying such non-payment provisions, thereby reducing the leverage of the hold-out creditors who cannot otherwise be bound because of the absence of a collective action clause.

In the context of an exchange offer, exit consents are used to allow bondholders, by tendering bonds in the exchange, automatically to vote in favour of the amendments to certain terms of the bonds they are about to leave. The completion of the exchange offer is predicated on bondholders holding the requisite majority agreeing to the amendment. Even if there were hold-outs who refused to participate in the exchange offer and therefore became a majority of the old bond (because everyone else has exited), the hold-outs would not be able to reverse the amendments without the consent of the sovereign issuer.

Amendment of some of the non-payment provisions could adversely affect the secondary market value of the old bond after the exchange or make it more difficult for remaining holders of the old bonds to pursue legal remedies against the sovereign issuer. For example, if the sovereign immunity waiver were removed from the bond terms through an exit amendment, hold-outs would be stripped of the ability to attach the sovereign issuer's assets (at least in those jurisdictions recognizing the amendment) in connection with a lawsuit based on the old bonds. Such an amendment would reduce the attractiveness of the old bonds, thereby discouraging investors from not participating in the exchange offer in the hope of subsequently being able to obtain a more favourable settlement.

Exit consents have been used to a limited extent in corporate bond exchanges in the United States and have withstood legal challenges in US courts. In general, US courts have read the terms of the bond strictly and have been reluctant to imply any fiduciary duties among creditors other than those explicitly in the terms of the bond. Thus they have refused to invalidate exit consents that removed important bondholder rights and protections, including financial covenants.

For a general discussion of issues concerning exit consents, see Lee C. Buchheit & G. Mitu Gulati, Exit Consents in Sovereign Bond Exchanges, 48 UCLA Law Review 59 (October 2000).

Aggregation clauses, (d). In addition to majority amendment clauses, the ability of a minority group to disrupt restructurings could also be addressed through the use of aggregation clauses. Such clauses would make it more difficult for hold-outs to establish a blocking position and could help sovereigns achieve a more comprehensive debt restructuring. The G10 Working Group considered the issue of aggregation, and the Report stated that: “This approach has a great deal of potential, especially within the context of bonds issued under the laws of a single jurisdiction, and merits further exploration.” However, it remains unclear in the context of normal debt management operations how feasible it would be to introduce aggregation clauses incrementally in new sovereign bond issues. Thus far, only the new bonds issued by Uruguay have contained limited forms of aggregation clauses.[1]

Avoiding disruptive legal action by individual creditors while protecting the interests of creditors as a whole

The Working Group recommended three provisions to achieve this objective:

a. a 25% bondholder vote for acceleration and a majority vote on rescission of acceleration [generally adopted];

b. concentrating the power to initiate litigation within a bondholder representative and explicitly prohibiting individual enforcement [generally not adopted]; and

c. the pro rata distribution of proceeds from litigation [generally not adopted].

While the recommendations in respect of acceleration and rescission have been widely adopted, there have not yet been many examples of the power to initiate litigation being concentrated in the hands of a bondholder representative in sovereign bonds issued under New York law.[2]

Both *acceleration provisions* with a 25% threshold and a clause requiring a majority (or a supermajority with a maximum of 66⅔%) for *rescission of acceleration, (a),* have been widely adopted. The members of the Working Group concluded that making the power to accelerate a bond in the event of a default dependent upon a collective vote of the creditors, and also providing for the ability to reverse such an acceleration, are critically important in deterring litigation, because the ability to declare principal and interest due and payable is an effective prerequisite for legal action.

Restrictions on individual action, (b). This is a key area where recent market practice has differed from the recommendations of the Working Group that bonds include a permanent bondholder representative (a trustee or alternative) with the sole power to initiate litigation. These sole powers would not only prevent individual creditors from pursuing claims, but would also protect the interests of bondholders as a group by requiring the representative to act on instruction from bondholders with 25% of the outstanding principle. (Individual bondholders would still be able to pursue litigation in the event that the representative failed to act on instructions in a timely fashion.)

It remains to be seen whether the failure to provide for a permanent bondholder representative will lessen the effectiveness of CACs as a tool to facilitate orderly debt restructurings. Litigation that might disrupt the prospects for more orderly sovereign debt restructurings has been rare, historically, but there is a distinct possibility it might increase in future. Recent uncertainty regarding the interpretation of the *pari passu* clause could be a factor encouraging increased litigation (see Box 2). The number of cases brought against Argentina is unprecedented. Actions have been brought in a number of jurisdictions, including on behalf of retail bondholders.[3] The

[1] The three new bonds issued by Uruguay in its exchange offer (along with subsequent issues by Uruguay) included a clause under the same trust indenture that enabled changes to two or more bonds to be approved by (i) holders of 85% of the aggregate principal amount of all series that are proposed to be affected, and (ii) holders of 66⅔% of outstanding principal of each individual series to be restructured. Such an aggregation clause makes it more difficult for holdouts to establish a blocking position. To be sure of success, a blocking position would have to be at least 33⅓% of the principal outstanding in a single series, or 15% of the total debt – compared with 25% of a single instrument with CACs requiring a 75% threshold. (The Uruguay bonds also restrict the future use of exit consents in order to ensure that any future restructuring should rely on CACs.)

[2] The two exceptions for New York law bonds are Uruguay and Indonesia, whose recent bonds were issued under a trust indenture.

[3] The spate of litigation generated by Argentina's default has also raised the issue of when sovereign immunity applies. There have been cases in Italy where immunity has been denied and others where it has been upheld.

initiation of legal proceedings against Argentina *before* a restructuring agreement has been reached could set a significant precedent and shift incentives toward more and earlier litigation. The use of class action procedures poses a particular complication for sovereign debt restructurings because a judge determines whether the terms of the exchange offer can be accepted by participants in a class action. Some of the complications arising from sovereign debt litigation could be mitigated if bond issues include a trust deed, because only the trustee, not individual bondholders, can then take legal action.

Hence, going forward it might be desirable to give further consideration to the role wider use of trust deeds (or alternatives structures) could play as a means of deterring litigation that might disrupt the prospects for more orderly sovereign debt restructurings.

Pro rata distribution of litigation proceeds (c). Sharing clauses require that litigation proceeds are shared across all bondholders on a pro rata basis, thereby reducing the incentive for individual bondholders to litigate. It is already typical when bonds are issued under a trust deed, but most sovereigns who have included CACs in issues made under New York law since March 2003 have not included a sharing clause.

Box 2: Recent rulings on the *pari passu* clause

Uncertainty regarding the legal interpretation of the *pari passu* clause included in sovereign bond contracts may contribute to increased litigation. In Elliot vs. Peru, a Belgian court interpreted *pari passu* as requiring *pro rata* payments to all creditors and prohibiting debtors from maintaining payments to selected third party creditors. This interpretation, if it were to be upheld, could enable creditors to attach payments intended for third parties. However, the more common interpretation of *pari passu* is to ensure that the bond in question ranks equally with other bonds and is not subordinated by the sovereign (see Buchheit and Pam, *The Pari Passu Clause in Sovereign Debt Instruments* available at www.law.harvard.edu/programs/pifs).

The Elliot precedent on *pari passu* was subsequently relied on by LNC in its litigation against Nicaragua. LNC initially succeeded in obtaining an *ex parte* order from the Brussels commercial court which effectively prevented Nicaragua from making payments on its external debt unless proportional payments were made to LNC. This order was overturned by the Brussels Court of Appeal on the grounds that the contractual *pari passu* clause did not give LNC an enforceable right against Euroclear.[2] However, LNC has appealed this decision to the Belgian Supreme Court and the Supreme Court is expected to make a ruling within the next year.

In December 2003, Argentina asked the New York court to clarify the meaning of *pari passu* in the context of a suit brought by EM Ltd. The Argentine legal brief argued *against* an interpretation of *pari passu* that would require debtors to share any payments across all creditors (including the IMF and other international financial institutions which traditionally enjoy preferred creditor status). The United States government submitted a statement of interest that also argued against the *pro rata* interpretation of the *pari passu* clause. However, the New York court deferred any decision on the interpretation of *pari passu* clauses until an Argentine creditor affirmatively asks the courts to clarify the meaning of *pari passu*. (The issue also arose in the Red Mountain v the Democratic Republic of the Congo judgement.)

Hence, the *pari passu* issue currently remains unresolved in the courts in both New York and Belgium and, until it is fully resolved, litigious creditors may continue to take action against sovereign creditors seeking to attach payments to third parties. However, the Belgian authorities are in the process of amending their law and this should make it more difficult for creditors to attach payments being made through Euroclear by resorting to litigation in future.

[2] Euroclear is the world's largest settlement system for domestic and international securities transactions.

V Concluding remarks

Both the activities of the G10 Working Group on Contractual Clauses and the efforts of seven major trade associations to produce a draft set of model clauses for use in sovereign bond issues were instrumental in preparing the ground for the acceptance of CACs as the market standard in sovereign bonds issued in New York, where they had not previously been widely used.

It is evident from this review of the CACs included in bonds over the past 19 months that the most important objective of providing effective means for creditors and debtors to recontract has been achieved through the widespread adoption of majority action provisions (thus binding in minorities and hold-out creditors). Market standards are also evolving with regard to disenfranchisement provisions (excluding bonds held directly or indirectly by the issuer from voting), hurdles for acceleration and deceleration, and rules for voting on non-reserved matters.

However, it is also apparent that, so far, only limited progress has been made on the other two key objectives identified by the G10 Working Group: fostering of early dialogue, coordination, and communication between creditors and sovereigns involved in a sovereign debt problem; and ensuring that disruptive legal action by individual creditors does not hamper a workout that is under way.

If and when a sovereign reaches a position when it is faced with no other viable course of action than to seek a restructuring of its outstanding debt, then there needs to be a clear road map so that both sovereigns and their creditors know what to do in these circumstances. There is also a need for incentives that encourage the parties involved to follow the road map. While the collective action clauses now being included in sovereign bonds issued under New York law are a most welcome step in drawing such a map, it is, nevertheless, doubtful whether this development by itself will be sufficient to address all the problems associated with sovereign restructurings.

Hence, it is to be hoped that, given time, private sector investors as well as issuers and their advisers will come to accept that it is in all their interests to include a wider range of provisions in sovereign bond issues. In particular, making provision for the appointment of a bondholder representative - who is empowered to act on behalf of all bondholders when requested to do so by an agreed percentage of the holders of an issue - would be a significant step. Such a provision could help to facilitate the achievement of both of the key objectives set out in the Working Group report - fostering of early dialogue, coordination, and communication among creditors and sovereigns, and ensuring that disruptive legal action by individual creditors does not hamper a workout - that have yet to be achieved.

Given the number of bonds some countries can have outstanding simultaneously, a further helpful step towards achieving a more orderly framework for restructuring sovereign debt may be to conduct more work exploring what may be required to facilitate the achievement of aggregation over a number of different issues. If achievable, aggregation could significantly contribute to the speed at which sovereign restructurings are negotiated.

A complementary means of achieving some of the Working Group's objectives - at least in respect of engagement and negotiation between a sovereign and its creditors - may be through the development of a voluntary set of principles (code of good conduct), achieved through a process of consultation between major sovereign issuers and private sector trade associations that represent the interests of both the sell and buy sides of the market.

Finally, while the focus of this assessment has been on international sovereign bonds - as this is now the primary means used by sovereigns to raise external finance – bonds are not the only instrument through which sovereigns incur external debt. Sovereigns also need to have ways in which to restructure their other (non-bonded) debts if the objective of creating an orderly system for sovereign debt restructurings is to be realised fully. Hence the Working Group expressed the "expectation that practices developed with respect to sovereign bonds could be implemented with appropriate modifications in other types of debt over time." For example, syndicated loans still represent a significant fraction of sovereign external debt and, since these loans are now more widely traded than was the case at the time of the 1980s debt crises, they may benefit from the inclusion of some more explicit collective action provisions in the original syndication documentation.

The widespread use of a broader range of CACs across a range of sovereign debt instruments - possibly used in combination with an agreed code of good conduct – would increase the prospects of achieving more orderly and comprehensive sovereign restructurings. Restructurings, which on the one hand provide sovereigns with sustainable debt profiles, and on the other hand, minimise the extent of losses suffered by creditors.

APPENDIX A:
COLLECTIVE ACTION CLAUSES IN SOME RECENT SOVEREIGN BONDS ISSUED UNDER NEW YORK LAW: DETAILED COMPARISON WITH THE G10'S RECOMMENDATIONS

G10 Recommendation	**Mexico**	**Uruguay**	**Brazil**	**Belize**[1]	**South Africa**	**Turkey**
Bond prospectus examined *(A few additional features which are not G10 recommendations are shown in italics)*	6.625% Notes due 2015, launched February 2003	New bonds from April 2003 exchange offer	10% Bonds due 2007, issued April 2003	9.75% Notes due 2015, issued June 2003	5.25% Notes due May 2013, issued May 2003	9.5% Notes due 2014, issued in September 2003

	Poland	**Korea**	**Italy**	**Colombia**	**Panama**	**Chile**	**Venezuela**
Bond prospectus examined *(A few additional features which are not G10 recommendations are shown in italics)*	5.25% Notes due 2014, issued in October 2003	4.25% Notes due 2013, issued May 2003	2.5% Notes due 2008, issued July 2003	8.125% Bonds due 2024, issued January 2004	8.125% Bonds due 2034, issued January 2004	FRN due 2008, issued January 2004	9.375% Bonds due 2034, issued January 2004

	Mexico	**Uruguay**	**Brazil**	**Belize**	**South Africa**	**Turkey**
Governing law	NY	NY	NY – but enforcement is by arbitration in NY[2].	NY	NY	NY

	Poland	**Korea**	**Italy**	**Colombia**	**Panama**	**Chile**	**Venezuela**
Governing law	NY	NY	NY	NY	NY	NY	NY

	Mexico	**Uruguay**	**Brazil**	**Belize**	**South Africa**	**Turkey**
Permanent bondholders' representative (trustee or other)	No – fiscal agent	Yes - Trustee	No – fiscal agent	No – fiscal agent	No – fiscal agent	No – fiscal agent

[1] Based on inspection of the preliminary offering memorandum.

[2] "Under Brazilian law, Brazil is prohibited from submitting to the jurisdiction of a foreign court for the purposes of adjudication on the merits in any dispute…" Prospectus of 12/2/02 p. 11.

G10 Recommendation	Poland	Korea	Italy	Colombia	Panama	Chile	Venezuela
Permanent bondholders' representative (trustee or other)	No – fiscal agent	No – fiscal agent	No – fiscal agent	No – fiscal agent	No – fiscal agent	No – fiscal agent	No – fiscal agent

	Mexico	Uruguay	Brazil	Belize	South Africa	Turkey
Bondholders' negotiating representative elected by ⅔ of bondholders	No	No	No	No	No	No

	Poland	Korea	Italy	Colombia	Panama	Chile	Venezuela
Bondholders' negotiating representative elected by ⅔ of bondholders	No	No	No	No	No	No	No

	Mexico	Uruguay	Brazil	Belize	South Africa	Turkey
Bondholders meeting to be convened at any time upon request of issuer, permanent representative, or bondholders representing 10% of principal.	Yes	Yes	Mix – 10% of bond-holders may request meeting only if an event of default has occurred.	Mix – 10% of bond-holders may request meeting only if an event of default has occurred.	Yes	Yes

	Poland	Korea	Italy	Colombia	Panama	Chile	Venezuela
Bondholders meeting to be convened at any time upon request of issuer, permanent representative, or bondholders representing 10% of principal.	Yes	Yes	Yes	Yes	Mix – 10% of bond-holders may request meeting only if an event of default has occurred.	Yes	Mix – 10% of bond-holders may request meeting only if an event of default has occurred.

G10 Recommendation	Mexico	Uruguay	Brazil	Belize	South Africa	Turkey
Majority action provisions for amendments to **reserved matters** – with vote of bondholders representing 75% of principal outstanding, by written procedure (or meeting).	Yes – also allows for a meeting with quorum identical to voting thresholds.	Yes – also allows for a meeting with quorum identical to voting thresholds.	No - requires 85% vote.	No - requires 85% vote.	Yes – also allows for a meeting with quorum identical to voting thresholds.	Yes

	Poland	Korea	Italy	Colombia	Panama	Chile	Venezuela
Majority action provisions for amendments to **reserved matters** – with vote of bondholders representing 75% of principal outstanding, by written procedure (or meeting).	Yes	Yes – also allows for a meeting with quorum identical to voting thresholds.	Yes – also allows for a meeting with quorum identical to voting thresholds.	Yes – also allows for a meeting with quorum identical to voting thresholds.	Yes	Yes – also allows for a meeting with quorum identical to voting thresholds.	No - requires 85% vote

	Mexico	Uruguay	Brazil	Belize	South Africa	Turkey
Majority action provisions for amendments to **reserved matters** – with vote of bondholders representing 75% of principal outstanding, by written procedure (or meeting).	Yes – also allows for a meeting with quorum identical to voting thresholds.	Yes – also allows for a meeting with quorum identical to voting thresholds.	No - requires 85% vote	No - requires 85% vote	Yes – also allows for a meeting with quorum identical to voting thresholds.	Yes

	Poland	Korea	Italy	Colombia	Panama	Chile	Venezuela
Majority action provisions for amendments to **reserved matters** – with vote of bondholders representing 75% of principal outstanding, by written procedure (or meeting).	Yes	Yes – also allows for a meeting with quorum identical to voting thresholds.	Yes – also allows for a meeting with quorum identical to voting thresholds.	Yes – also allows for a meeting with quorum identical to voting thresholds.	Yes	Yes – also allows for a meeting with quorum identical to voting thresholds.	No - requires 85% vote

G10 Recommendation	Mexico	Uruguay	Brazil	Belize	South Africa	Turkey
Reserved matters: (i) change the payment date; (ii) reduce the principal amount; (iii) reduce the portion of the principal amount due in the event of an acceleration; (iv) reduce the interest rate; (v) change the currency or place of payment; (vi) change the obligation of the issuer to pay additional amounts, (vii) change the definition of outstanding or reduce the voting requirements; (viii) authorize the permanent representative to exchange the bonds; (ix) instruct the permanent representative to settle or compromise any proceeding; (x) give to any person the exclusive right to enforce any provision; or (xi) appoint a negotiating representative for any proposed restructuring of the bonds.	Similar to G10 (i) – (vii), also adds governing law, jurisdiction, status (pari passu), event of default.	Similar to G10 (i) – (viii), also adds change to pari passu ranking, governing law, jurisdiction. Also adds that if a change to a reserved matter is sought as part of exchange then terms must not be less favourable than those of new notes (i.e. restriction on use of exit consents).	Similar to G10 (i) – (vii), also adds governing law, jurisdiction, status (pari passu), event of default.	Similar to G10 (i) – (vii), also adds governing law, jurisdiction, status (pari passu), event of default.	Similar to G10 (i) – (vii), also adds govern-ing law, jurisdiction, status (pari passu), event of default.	Similar to G10 (i) – (vii)

G10 Recommendation	Poland	Korea	Italy	Colombia	Panama	Chile	Venezuela
Reserved matters: (i) change the payment date; (ii) reduce the principal amount; (iii) reduce the portion of the principal amount due in the event of an acceleration; (iv) reduce the interest rate; (v) change the currency or place of payment; (vi) change the obligation of the issuer to pay additional amounts, (vii) change the definition of outstanding or reduce the voting requirements; (viii) authorize the permanent representative to exchange the bonds; (ix) instruct the permanent representative to settle or compromise any proceeding; (x) give to any person the exclusive right to enforce any provision; or (xi) appoint a negotiating representative for any proposed restructuring of the bonds.	Similar to G10 (i) – (vii), also adds changes to governing law or jurisdiction.	Similar to G10 (i) – (vii), also adds governing law, jurisdiction, status (pari passu), event of default.	Similar to G10 (i) – (vii), also adds governing law and jurisdiction.	Similar to G10 (i) – (vii), also adds change to pari passu ranking, governing law, jurisdiction, events of default.	Similar to G10 (i) – (vii), also adds change to pari passu ranking, governing law, jurisdiction, events of default.	Similar to G10 (i) – (vii), also adds change to pari passu ranking, governing law, jurisdiction, events of default.	Similar to G10 (i) – (vii), also adds governing law, jurisdiction, status (pari passu), event of default.

	Mexico	Uruguay	Brazil	Belize	South Africa	Turkey
Majority action provisions for amendments to **non-reserved matters** – with vote of bondholders representing 66⅔% of principal outstanding, either in writing or in a meeting.	Yes	Yes – also adds aggregation clause.	Yes	Yes	Yes	Yes

G10 Recommendation	Poland	Korea	Italy	Colombia	Panama	Chile	Venezuela
Majority action provisions for amendments to **non-reserved matters** – with vote of bondholders representing 66⅔% of principal outstanding, either in writing or in a meeting.	Yes	Yes	Yes	Yes	Yes	Mix – requires 50% for amendments to non-reserved matters.	Yes

	Mexico	Uruguay	Brazil	Belize	South Africa	Turkey
Non-material amendments may be made without the bondholders' consent	Yes	No (as far as aware)	Yes	Yes	Yes	Yes

	Poland	Korea	Italy	Colombia	Panama	Chile	Venezuela
Non-material amendments may be made without the bondholders' consent	Yes	Yes	Yes	Yes	Yes	Yes	Yes

	Mexico	Uruguay	Brazil	Belize	South Africa	Turkey
Majority enforcement: **Acceleration** in the event of default, upon decision of permanent representative, or on instruction by bondholders representing 25% of principal;	Yes	Yes – allows individual action if trustee fails to act within 60 days of instruction.	Yes	Yes	Yes	Yes

	Poland	Korea	Italy	Colombia	Panama	Chile	Venezuela
Majority enforcement: **Acceleration** in the event of default, upon decision of permanent representative, or on instruction by bondholders representing 25% of principal;	Mix – individuals can accelerate if non-payment or moratorium, need 25% threshold for other events of default.	Yes	Yes	Yes	Yes	Yes	Yes

G10 Recommendation	Mexico	Uruguay	Brazil	Belize	South Africa	Turkey
Majority enforcement: **Rescission of acceleration** provided default is cured, waived, or remedied, upon decision of bondholders representing 50-66⅔% of principal outstanding.	Yes –50+% can agree if default is remedied.	Yes – 66⅔% can agree, also specifies some requirements for remedy of default.	Yes – 66⅔% can agree if default is remedied.	No	Yes –50+% can agree if default is remedied.	Yes – 66⅔% can agree if default is remedied.

	Poland	Korea	Italy	Colombia	Panama	Chile	Venezuela
Majority enforcement: **Rescission of acceleration** provided default is cured, waived, or remedied, upon decision of bondholders representing 50-66⅔% of principal outstanding.	Mix – no provision for non-payment or moratorium, but 50+% can agree rescission of acceleration for other defaults and if default is remedied.	Yes –50+% can agree if default is remedied.	Yes – 66⅔% can agree if default is remedied.	Yes –50+% can agree if default is remedied.	Yes – 66⅔% can agree if default is remedied.	Yes –50+% can agree if default is remedied.	Yes –50+% can agree if default is remedied.

	Mexico	Uruguay	Brazil	Belize	South Africa	Turkey
Majority enforcement: **litigation** to be instituted solely by the permanent representative, or upon instruction by bondholders representing 25% of principal, and provided the representative has reasonable indemnification, unless the representative has failed to act within 90 days (after which individuals can litigate).	No	Yes – but can act individually if trustee fails to act within 60 days.	No	No	No	No

G10 Recommendation	Poland	Korea	Italy	Colombia	Panama	Chile	Venezuela
Majority enforcement: **litigation** to be instituted solely by the permanent representative, or upon instruction by bondholders representing 25% of principal, and provided the representative has reasonable indemnification, unless the representative has failed to act within 90 days (after which individuals can litigate).	No	No	No	No	No	No	No

	Mexico	Uruguay	Brazil	Belize	South Africa	Turkey
Continuation and outcome of litigation – majority (over 50%) of bondholders may direct litigation.	No	No	No	No	No	No

	Poland	Korea	Italy	Colombia	Panama	Chile	Venezuela
Continuation and outcome of litigation – majority (over 50%) of bondholders may direct litigation.	No	No	No	No	No	No	No

	Mexico	Uruguay	Brazil	Belize	South Africa	Turkey
Continuation and outcome of litigation: pro-rata distribution of proceeds.	No	Yes	No	No	No	No

	Poland	Korea	Italy	Colombia	Panama	Chile	Venezuela
Continuation and outcome of litigation: pro-rata distribution of proceeds.	No	No	No	No	No	No	No

G10 Recommendation	Mexico	Uruguay	Brazil	Belize	South Africa	Turkey
Disenfranchisement provision – which excludes from participating in any votes any bonds owned or controlled, directly or indirectly, by the issuer or its public instrumentalities.	Yes	Yes – and also requires Uruguay to certify and specifying holdings.	Yes	No	Yes	Yes

	Poland	Korea	Italy	Colombia	Panama	Chile	Venezuela
Disenfranchisement provision – which excludes from participating in any votes any bonds owned or controlled, directly or indirectly, by the issuer or its public instrumentalities.	Yes	Yes	Yes – but securities owned by Bank of Italy or Italian Regions can vote.	Yes	Yes	Yes	Yes

	Mexico	Uruguay	Brazil	Belize	South Africa	Turkey
Information provision – to be included on a case by case basis.	No	Yes if seeking modification – then additional justification and information provision is required – including treatment of other creditors.	No	No	No	No

	Poland	Korea	Italy	Colombia	Panama	Chile	Venezuela
Information provision – to be included on a case by case basis.	No	No	No	No	No	No	No

G10 Recommendation	Mexico	Uruguay	Brazil	Belize	South Africa	Turkey
Events of default	Non-payment of 30 days, breach of other obligations and not acting within 30 days of notification by any bondholder, cross default with external debt, moratorium on external debt.	Non-payment of 30 days, breach of other obligations of 60 days, cross default, moratorium, end of IMF membership and more.	Non-payment of 30 days, breach of other obligations and not acting within 30 days of notification by any bondholder, cross default with external debt, moratorium on external debt.	Non-payment of 30 days, breach of other obligations and not acting within 90 days of notification by 25% of bondholders, cross default with external debt, moratorium on any debt, and more.	Non-payment of 30 days, breach of other obligations of 60 days, cross default with external debt, moratorium on external debt.	Non-payment of 30 days, breach of other obligations of 60 days, cross default, end of IMF membership

	Poland	Korea	Italy	Colombia	Panama	Chile	Venezuela
Events of default	Non-payment of 30 days, breach of other obligations of 45 days, cross default, or moratorium.	Non-payment of 30 days, breach of other obligations of 60 days, cross default, or moratorium.	Non-payment of 30 days, breach of other obligations of 60 days, cross default with external debt, moratorium on the payment of any external debt.	Non-payment of 30 days, breach of other obligations and doesn't act within 45 days of notification by any bondholder, cross default with external debt, moratorium on any debt, end of IMF membership and more.	Non-payment of 15 days on principal, non-payment of 30 days on interest, breach of other obligations and non acting within 60 days of notification by any bondholder, cross default with public debt, moratorium on external debt.	Non-payment of 30 days, breach of other obligations and not acting within 60 days of notification by any bondholder, cross default with external debt, moratorium on external debt.	Non-payment of 30 days, breach of other obligations and not acting within 30/90 days (as applicable) of notification by any bondholder, cross default with external debt, end of IMF membership, and more.

APPENDIX B: COMPARISON OF THE G10 RECOMMENDATIONS WITH THE PROPOSALS MADE BY A GROUP OF SEVEN TRADE ASSOCIATIONS[1] [2]

Both the G10 and the seven trade associations proposed model features for CACs in sovereign bonds issued under New York law. The key features and how they compare with evolving market practice are summarised below.

The main differences are that:

- The G10 recommended the use of a trustee (or alternative) as a representative of bondholders and the accompanying restrictions on litigation, while the trade associations prefer the use of a fiscal agent who is the agent of the issuer (rather than bondholders) without any restrictions on individual litigation;

- The G10 recommended lower voting thresholds for amendments than the trade associations;

- The trade associations recommended a wider set of reserved matters than those proposed by the G10; and

- The trade associations proposed more demanding information requirements than the G10.

Market practice is a mix of both. Many of the G10 recommendations have been taken on board, most importantly the majority action provisions. But issuers have generally chosen a fiscal agent structure rather than a trustee or alternative, consistent with the trade associations' proposal.

[1] IPMA, IIF, EMCA, EMTA, SIA, ISMA, and TBMA

[2] The Report of the G-10 Working Group on Contractual Clauses was published in March 2003 and can be found at: http://www.bis.org/publ/gten08.htm#pgtop. The trade associations' proposals were circulated in January 2003 and are available at: http://www.emta.org/ndevelop/Final_merged.pdf .

G10 Recommendations for New York law bonds	**Trade Associations' proposals for New York law bonds**	**Market practice – in bonds issued by Mexico (and others)**
Permanent bondholders' representative (trustee or other).	No – fiscal agent, who represents the issuer.	Trade Associations. Fiscal agent in all recent NY law issues except Uruguay.
Bondholders' negotiating representative elected by ⅔ of bondholders	The 'Engagement clause' provides, in the event of default or restructuring, for bondholders to elect a representative *committee* (or individual) with votes from 50% of bondholders, unless more than 25% object. The representative(s) could engage legal counsel and financial advisors and the issuer would pay for the costs.	Neither. No provision for representation (as far as aware).
Bondholders meeting to be convened at any time upon request of issuer, permanent representative, or 10% of bondholders.	Adds lower 5% threshold for bondholders to request Fiscal agent to call a meeting in the event of default, or if a restructuring is announced.	Consistent with both. Slightly closer to G10.
Majority action provisions for amendments to reserved matters with 75% vote	Higher threshold of 85% and adds that changes to reserved matters are prohibited if more than 10% object. Also includes some matters which require 100% consent to change.	Closer to G10 (only Brazil and Belize chose 85%).
List of reserved matters: (i) change the payment date; (ii) reduce the principal amount; (iii) reduce the portion of the principal amount due in the event of an acceleration; (iv) reduce the interest rate; (v) change the currency or place of payment; (vi) change the obligation of the issuer to pay additional amounts; (vii) change the definition of outstanding or reduce the voting requirements; (viii) to (xi) regarding permanent representative and enforcement.	Covers (i) to (vii). Also adds changes to the *pari passu* (or other specified substantive covenants) as appropriate; and any detrimental changes to the events of default or negative pledge provisions. Also adds that changes to the following require 100% consent: governing law, jurisdiction, and waiver of sovereign immunity.	Elements of both. Most cover G10 reserved matters (i) to (vii) but also add *pari passu*, events of default, governing law and jurisdiction (with 75% threshold).
Majority action provisions for amendments to non-reserved matters with 66⅔ % vote.	Higher threshold of 75%.	G10.
Amendments can be agreed in writing or at a meeting.	Yes	Consistent with both.
Acceleration instruction by bondholders representing 25% of principal	Yes	Consistent with both.
Rescission of acceleration decision by 66⅔ % of bondholders.	High threshold of 75% vote.	Closer to G10 – mix of thresholds of 66⅔% and 50% (neither as high as Trade Associations 75%).
Litigation to be instituted solely by the permanent representative.	No	Trade Associations.

G10 Recommendations for New York law bonds	Trade Associations' proposals for New York law bonds	Market practice – in bonds issued by Mexico (and others)
Continuation and outcome of litigation – directed by majority of bondholders.	No	Trade Associations.
Pro-rata distribution of proceeds.	No	Trade Associations.
Disenfranchisement provision.	Yes	Consistent with both.
Information provision – to be included on a case by case basis.	Requires: SDDS subscription and compliance; publication of 12-month forecasts of central government budget and inflation; Paris Club minutes and terms of agreement; terms of any other restructuring agreements; terms of IMF arrangements; and other information that the fiscal agent, on instruction of 5% of bondholders, may from time to time reasonably request. Notices and other information provided to bondholders must also be given to IPMA, EMTA, EMCA, and the IIF for publication on their websites.	Neither. Only Uruguay has included information requirements and they would apply only in the event that it seeks amendments.