Sovereign debt restructuring experiences

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Setting the scene

- **Greetings and thanks**.
  - Legal points but also points of political economy
  - Lawyer not an economist (or a Hebrew prophet)
- **Sovereign Debt Restructuring Experiences**
  - Why is restructuring sovereign debt different
  - What sovereign debt is to be restructured and how?
  - What are the key considerations in a restructuring?
  - Who pays?
  - What is the next day for the sovereign?
  - What should you be looking to do if you think a restructuring is necessary?
- **Background and context**. General principles, Greece and Argentina.
- **Questions & discussion**.

Why is restructuring sovereign debt different?

- State insolvency: a legal vacuum without bankruptcy law
- Sovereign is the source of law and above the law: *Dieu et Mon Droit*
- Corporate insolvencies are highly regulated. Law determines:
  - debt to be rescheduled (all), ranking of creditors, realisation of assets, disclosure of information, setting aside of preferences, liability of directors, discharge (and winding up) of the debtor
- Sovereign debt subject to domestic/internal law can be settled by the sovereign as the sovereign wishes
- Sovereign debt subject to external law needs to be restructured by agreement and consensus

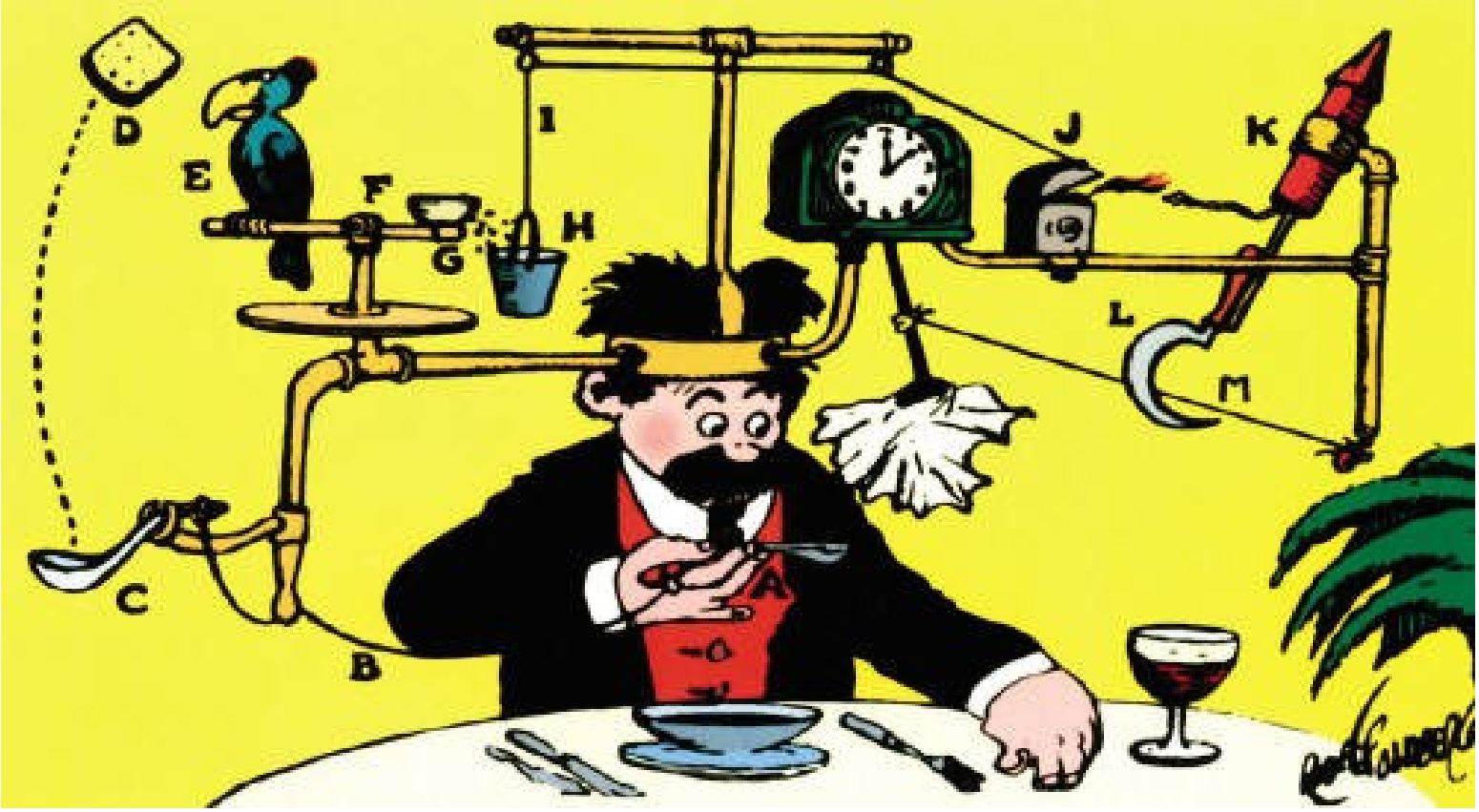
What sovereign debt is to be restructured?

- Who are the creditors?
  - Private sector – banks, pension funds, individual savers, long term investors ("real money"), short term ("hedge funds")
  - official sector – other sovereigns (Paris Club and non Paris Club), multilaterals, (IMF, ESM, ECB), development banks (IFC, EBRD)
- Type of debt
  - Bonds, Loans
  - Guaranteed debt? Swaps?
- Debtor state offers to exchange old bonds and loans for new rescheduled bonds or loans [may also declare a moratorium]
- Some inter-government debt rescheduled through Paris Club
- Not all debt is rescheduled: T-bills, trade and small debt, "prior official sector debt (IMF, ESM? ECB?)
- Governing law and key terms

How is sovereign debt to be restructured?

- "Restructuring" or "Rescheduling" covers a multitude of options
  - an exchange of outstanding sovereign debt instruments, such as loans or bonds, for new debt instruments or cash through a legal process [on terms less favourable than the original loan or bond]
- Debt rescheduling – repayment dates are extended
- Debt reduction – nominal amount is reduced
- Incentives - "Sweeteners"
  - Cash offered for a small percentage
  - GDP growth warrants are offered
- Calculations of debt reduction - face value vs. present value of new debt (discount rate?)
- What offer to make?
  - Will the majority accept? Can I bind the minority? Collective action issues.
  - How can I set up my payments so as to avoid attacks by "holdouts"?

Restructuring is always a matter of delicate design



What are the key considerations in a restructuring?

- Reschedule or reduce the debt?
- Default or negotiate first?
- Is this a liquidity crisis? Is the debt sustainable? Is the country solvent?
- What solution is acceptable to the voters? the EU partners?
- What solution satisfies the policies of the ECB and the IMF?
- What solution complies with EU treaties?
- What will be the rating downgrade implications
- Who are the creditors? What are their expectations?
- How will the bonds behave in the hands of banks and insurers?
  - Will government bonds be eligible collateral?
  - What will be the accounting treatment?
  - What will be the effect of the rating downgrade and “selective default”?
- Internal and external systemic implications for banks and insurers?
- Collateral consequences: what will happen to CDSs & corporate debt?

Key risks for debt – how does your debt rate?

- Debt to GDP: an indicator or limited importance
- Amount – currency risk
- Maturity – refinancing risk
- Cost – interest rate risk
- Other terms which could destabilise debt
- Identity of creditors

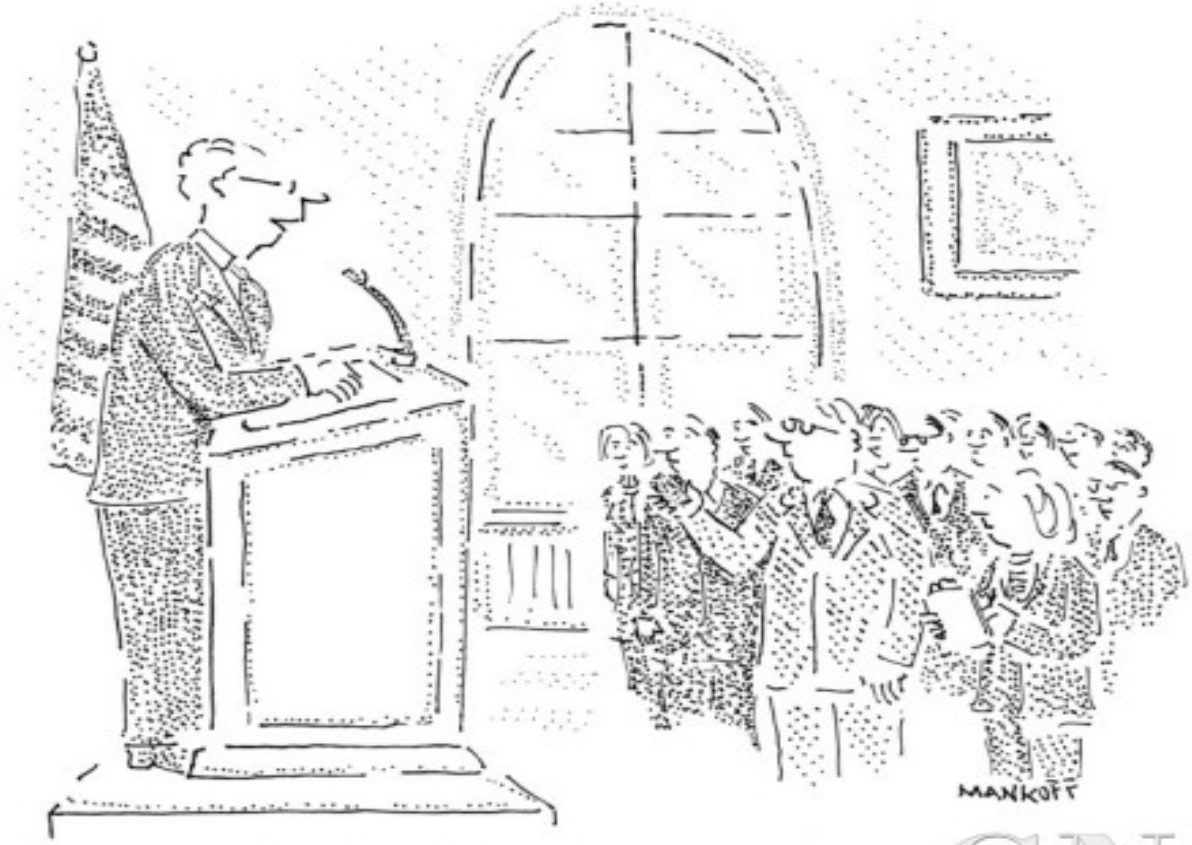
Who pays? Appropriate criteria for loss allocation.

- Criteria
  - Incentives (before and after the restructuring)
  - Fairness (within and across countries – across generations?)
  - Ability to pay, impact on financial stability, impact on growth
- Who pays?
  - Creditors (domestic, foreign)
  - National Taxpayers
  - Beneficiaries of public expenditures public employees, pensioners, users of public services.
  - Bank depositors?
  - Taxpayers of other countries
- Is all this sustainable the day after?

What is the next day for the sovereign?

- Is the debt now sustainable?
- Are the economy, the public sector and the banks sufficiently changed so as not to give birth to the same problem again?
- Do the corporates, the banks and the sovereign have access to markets?
- Are the banks able to continue financing the economy?
- Has the social fabric of the country withstood the tensions of the crisis?
- Has the sovereign made a new start?
- Has the sovereign re-joined the community of nations or has it become an isolated pariah?

Questions?



"That's a very good question, which is why we're going to move on to the next question."

Questions?

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