

**FOR
AGENDA**

SM/03/102
Correction 1

April 3, 2003

To: Members of the Executive Board

From: The Secretary

Subject: **Collective Action Clauses—Recent Developments and Issues**

The attached correction to SM/03/102 (3/25/03) have been provided by the staff:

Page 8, Box 1, row 2, column 3: for “Excluded bonds: none”
read “Excluded bonds: bonds owned directly or indirectly by
the issuer”

Page 19, para. 46, lines 12–15: for “Although the bonds issued by Egypt and Qatar also
include majority enforcement provisions that would require
25 percent of outstanding principal to accelerate the bond
(which is consistent with prevailing New York practice), the
Lebanese bonds do not contain such provisions.”
read “Although the bonds issued by Egypt and Qatar also
include a very limited form of majority enforcement provision,
the Lebanese bonds do not contain such provisions.”

line 15: add footnote 21 to read: “Although the majority enforcement
provisions contained in the Egypt and Qatar bonds would
require the support of at least 25 percent of outstanding
principal to accelerate the entire issue, individual bondholders
would still have the right to accelerate their own claims.”

Questions may be referred to Mr. Bertuch-Samuels, ICM (ext. 34786), Mr. Hagan, LEG
(ext. 37715), and Mr. Allen, PDR (ext. 38786).

Att: (2)

Other Distribution:
Department Heads

in international sovereign bonds. For example, the G-10 Working Group Report indicated that further consideration would be given as to the type of nonpublic information that could be provided that would not require confidentiality agreements.

18. ***Consistency with Domestic Laws*** – The G-10 Working Group Report noted that its recommendations could be incorporated into sovereign bonds governed by English, French and New York law immediately and in bonds governed by Japanese law with some modifications. In the case of Germany, the G-10 Working Group noted that market participants are willing to implement a structure reflecting the above provisions under certain conditions. Some market participants are of the view that legislative clarification would be necessary to support the validity of these clauses. While the German government has confirmed in public the validity of these clauses under German law, it is nevertheless preparing legislation designed to dispel any remaining doubts on this question in order to promote the broader use of CACs.

III. WORK DONE BY THE PRIVATE SECTOR IN DEVELOPING MODEL CLAUSES

19. **With a view to strengthening the crisis resolution frameworks for emerging markets, the Institute of International Finance and six other financial industry trade associations recently put forward for discussion a draft set of model collective action clauses developed for bonds governed by New York law and English law (the “Industry Associations Draft”).**⁹ This initiative is a welcome step by these associations to engage in an effort to improve the crisis resolution framework. However, and as will be discussed below, the Industry Associations Draft falls short of recommending adopting the type of collective action clauses that are already included in many international sovereign bonds. Moreover, the rationale for some of the proposed changes to existing market practice under English law is unclear.

20. **Relative to the recommendations contained in the G-10 Working Group Report, the Industry Associations Draft seeks greater standardization of clauses, while recognizing that there may continue to be differences between bonds governed by New York law and those governed by English law.** Moreover, the Industry Associations Draft includes far more detailed covenants regarding the provision of financial information. Set forth below is an analysis of the proposed design of these clauses, including a comparison with: (i) those collective action clauses that already exist in international sovereign bonds, and (ii) those provisions recommended in the G-10 Working Group Report. Box 1 contains a summary of this comparative analysis.

⁹ The six financial industry associations are the Emerging Market Traders Association (EMTA), the International Primary Market Association (IPMA), the Bond Market Association (BMA), the Securities Industry Association (SIA), the International Securities Market Association (ISMA), and the Emerging Markets Creditors Association (EMCA).

Box 1. Existing and Proposed Collective Action Clauses

PROVISIONS	ENGLISH LAW GOVERNED BONDS	NEW YORK LAW GOVERNED BONDS	G-10 RECOMMENDATIONS	INDUSTRY ASSOCIATIONS DRAFT	MEXICAN BONDS GOVERNED BY NEW YORK LAW
Amendment of key terms, including payment terms	<ul style="list-style-type: none"> <i>Voting thresholds</i> 75% based on votes cast at duly convened meeting. Quorum requirement for meeting: 75% for first meeting; 25% for adjourned meeting. 	<ul style="list-style-type: none"> <i>Voting thresholds:</i> unanimous consent 	<ul style="list-style-type: none"> <i>Voting thresholds:</i> 75% based on either outstanding principal or duly convened meeting 	<ul style="list-style-type: none"> <i>Voting thresholds:</i> based on outstanding principal, 85% for key terms unless more than 10% object; unanimous consent for governing law, submission to jurisdiction, waiver of sovereign immunity and service of process; and 75% for other terms 	<ul style="list-style-type: none"> <i>Voting thresholds:</i> based on outstanding principal; 75% for key terms (including governing law and submission to jurisdiction)
Disenfranchisement	<ul style="list-style-type: none"> <i>Excluded bonds:</i> bonds held for the benefit of the issuer 	<ul style="list-style-type: none"> <i>Excluded bonds:</i> bonds owned directly or indirectly by the issuer 	<ul style="list-style-type: none"> <i>Excluded bonds:</i> bonds owned or controlled directly or indirectly, by the issuer or any of its public sector instrumentalities 	<ul style="list-style-type: none"> <i>Excluded bonds:</i> bonds owned directly or indirectly by Mexico or any of its public sector instrumentalities 	<ul style="list-style-type: none"> <i>Excluded bonds:</i> bonds owned directly or indirectly by Mexico or any of its public sector instrumentalities
Events of Default and Acceleration	<ul style="list-style-type: none"> <i>Acceleration:</i> typically 25%; trustee has discretion <i>De-acceleration:</i> none, but achieved through majority restructuring clauses 	<ul style="list-style-type: none"> <i>Acceleration:</i> typically 25% <i>De-acceleration:</i> typically more than 50%, but in some cases 75% 	<ul style="list-style-type: none"> <i>Acceleration:</i> 25%; trustee has discretion <i>De-acceleration:</i> 50-66⅔% 	<ul style="list-style-type: none"> <i>Acceleration:</i> 25% <i>De-acceleration:</i> 75% 	<ul style="list-style-type: none"> <i>Acceleration:</i> 25% <i>De-acceleration:</i> more than 50%

discernible impact on price or liquidity. In April 2000, Canada announced that it would include CACs in its future foreign jurisdiction bond and note issues.

45. **In September 2002, EU Finance Ministers stated that EU countries' sovereign bonds issued under foreign jurisdictions (i.e. bonds governed by a foreign law or subject to the jurisdiction of a foreign court) would henceforth include CACs.** Although such bonds are a small part of overall bond issuance by EU countries, there are a number of countries that have issued in foreign jurisdictions in the past few years, such as Austria, Finland, Italy, Portugal, and Spain.¹⁹ The intent of this step is to "lead by example", thereby facilitating the incorporation of such clauses in bonds issued by emerging market countries.

Emerging Market Issuers

46. ***Egypt, Lebanon, and Qatar*** – There have also been important developments with respect to emerging market issuers. Although the most publicized case is the recent issuance by Mexico, which is discussed in considerable detail below, three other emerging market countries have also successfully included majority restructuring provisions in bonds governed by New York law. Specifically, Egypt, Lebanon and Qatar issued bonds under New York law, which in the U.S. were offered to institutional investors under Section 144A of the U.S. Securities Act of 1933.²⁰ Lebanon's Global Medium Term Note Program launched in June 2000, Qatar's bonds issued in June 2000, and Egypt's bonds issued in June 2001, all contain majority restructuring provisions. While, in the case of Lebanon and Qatar, the provisions include a 75 percent voting threshold based on the claims bondholders present at a duly convened meeting, the Egyptian bond provides for an 85 percent threshold calculated on the basis of the outstanding principal amount. Although the bonds issued by Egypt and Qatar also include a very limited form of majority enforcement provision, the Lebanese bonds do not contain such provisions.²¹ None of the bonds were issued under a trust deed.

¹⁹ Overall issuance by EU countries of international sovereign bonds is estimated to amount to roughly 3½ percent of the outstanding stock of bonds (this includes issuance by an EU country in another EU country). However, while the share of international bonds issued by EU members is relatively small, the EU represents a sizeable portion of the global market. It is estimated that, since 1996, over € 37 billion in bonds was issued by EU countries through New York, and roughly € 6 billion through the German market – a possible indication of the impact future use of CACs could have on changing market practice in these jurisdictions.

²⁰ Rule 144A provides a "safe harbor" from the registration statements of the U.S. Securities Act of 1933 and is often used for the secondary sales of unregistered securities to "qualified institutional buyers."

²¹ Although the majority enforcement provisions contained in the Egypt and Qatar bonds would require the support of at least 25 percent of outstanding principal to accelerate the entire issue, individual bondholders would still have the right to accelerate their own claims.

47. **At the time of issuance of these bonds, there was no discussion among market participants concerning their inclusion of majority restructuring provisions.** In recent months, however, as the general discussion of CACs made investors aware that the Egyptian bonds included these provisions, there was no indication that the market penalized these bonds for their inclusion of CACs.²²

Mexico

48. **In March 2003, Mexico issued bonds governed by New York law that included both majority restructuring provisions and majority enforcement provisions.** This issuance has garnered considerable attention because there had been extensive discussion of CACs prior to the issuance. More specifically, the issuance follows the completion of both the G-10 Working Group Report and the Industry Associations Draft. Accordingly, there has been considerable interest as to the manner in which the provisions proposed by the G-10 Working Group and the Industry Associations Draft were applied by Mexico. Moreover, a detailed discussion of the CACs took place with investors when the bonds were marketed.

49. **A close look at the provisions reveal that they are generally—but not entirely—consistent with the types of clauses recommended by the G-10 Working Group and attempt to achieve a careful balance between the objective of resolving collective action problems and protecting creditor rights.** While these provisions also include some of the features proposed in the Industry Associations Draft, they depart from the Industry Associations Draft in a number of important respects.

50. ***Majority Restructuring Provisions*** – The Mexican bonds provide that the payment terms may be amended by 75 percent of the outstanding principal amount.²³ The 75 percent threshold is consistent with the prevailing practice for bonds governed by English law. However, the reliance on the outstanding principal amount as the basis for calculating whether the threshold has been met deviates from English practice but, when taken together with the 75 percent voting threshold, follows the recommendations of the G-10 Working Group Report. As noted earlier, reliance on the outstanding principal as a means of calculating whether the voting threshold has been met was viewed by the G-10 Working Group as a possible way addressing the specific concerns of U.S. investors. While the Industry Associations Draft also utilizes the outstanding principal approach, its proposed voting threshold is higher than 75 percent.

²² In recent months there was a rally in the price of Egyptian bonds that was independent of the inclusion of CACs and was likely associated with the floating of the Egyptian pound, which was interpreted by the market as a positive credit event.

²³ Among the terms subject to the 75 percent threshold are the provision on governing law and the submission to foreign jurisdiction.