Public Debt Trusts

Speaker:

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Introduction

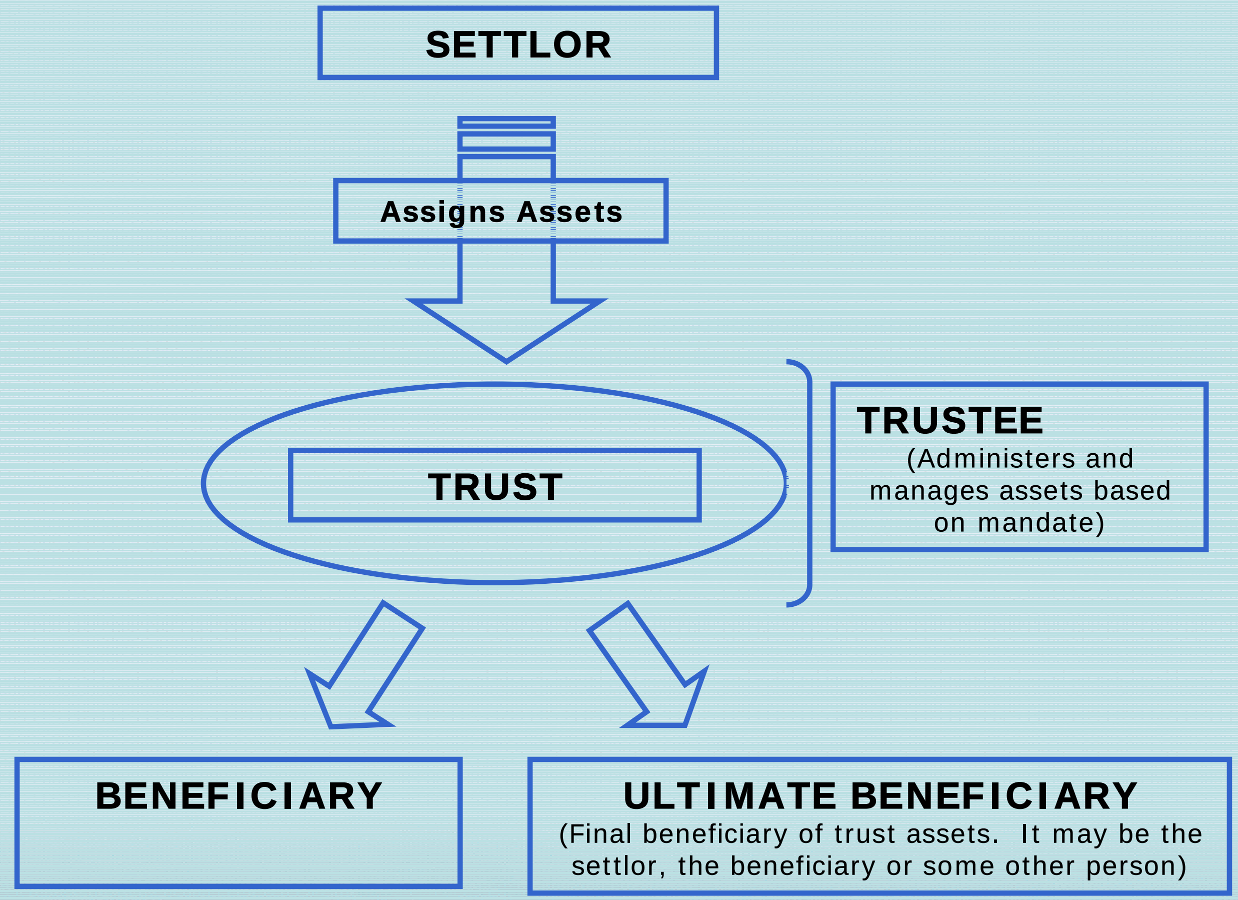
- Debt had.s been increasing since the 70s

➢ Shifted from syndicated loans in the 80s to bonds in the 90s

➢ Trusts began being used in this context

II- Trusts. Concept, parties and most common uses

Trust Structure



Financial Trusts

- **Public Financial Trusts**
  - Originated in a regulation
  - Government must intervene as settlor
  - Trust property consists of state assets
  - Have a public interest purpose
- **Private Financial Trusts**

DEBT MARKET PLAYERS

Debt in the 70s and 80s

- Creditors: Large Investment Banks
- International lending organizations
- Sovereign states (emerging countries)

Debt in the 90s

- Private individual investors
- Private institutional investors (banks and mutual funds)
- International lending organizations
- Risk rating agencies
- Sovereign states (emerging countries)

The problem of "holdouts"

A country faces financial problems

- With bank loans (80s) → Direct negotiation with banks
- With bonds (90s)

Problems to negotiate
-Spread-out creditors: cannot be identified
-Diversified creditors: purchase and do not cooperate

Proposal to swap old debt for new debt (unilateral)

Some bondholders accept and swap (with reduction in principal)

Holdouts
-Others reject the proposal and keep old bonds
-Vulture funds purchase bonds in secondary markets at low prices (reflecting the reduction)

The country does not pay Holdouts

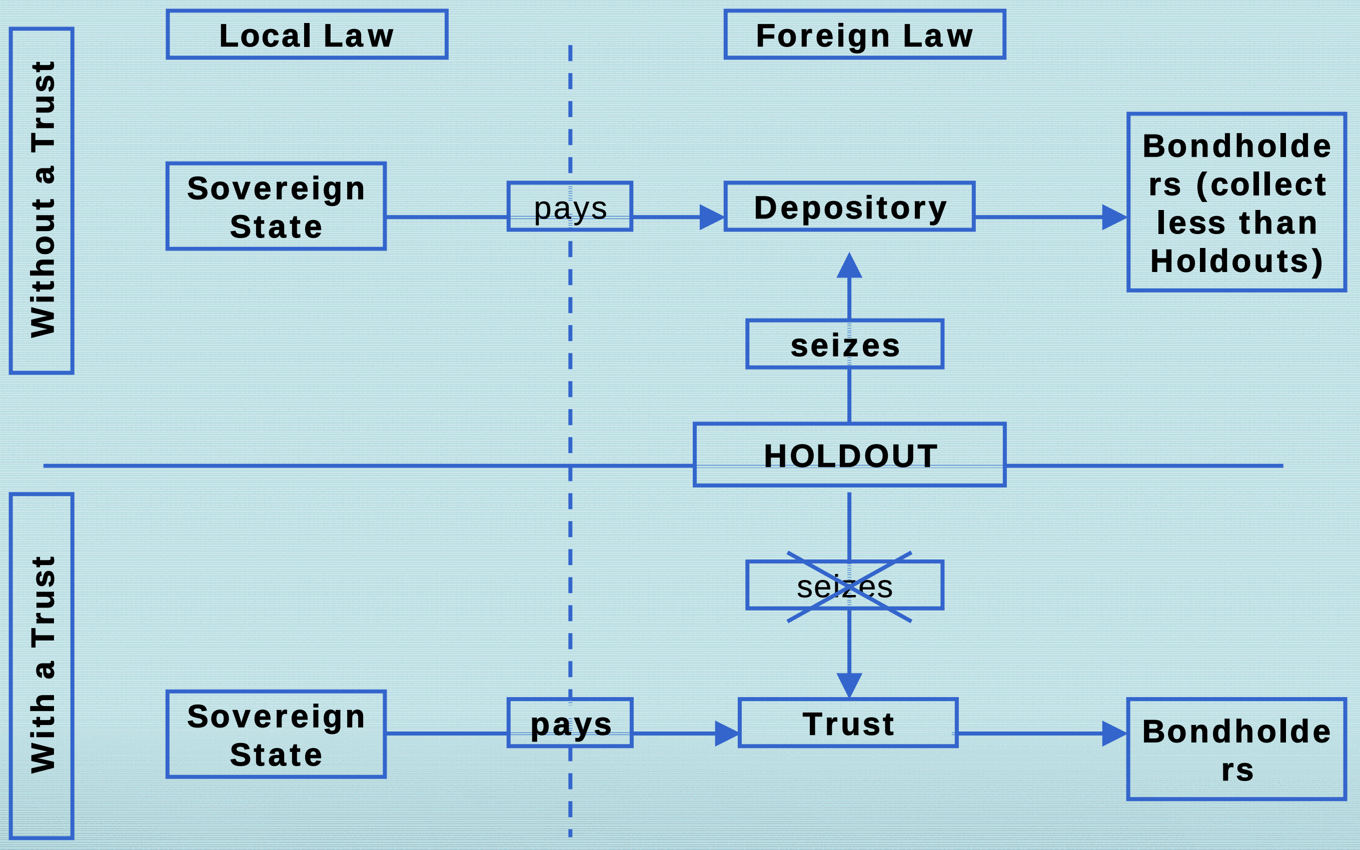
Litigation risk

The country pays Holdouts

Accepting bondholders feel deceived

NOBODY will accept a Swap Proposal in the next payment crisis (of any country)

Trust and Holdouts



The trust defines the obligations

Positive covenants

- repayment of principal and payment of interest
- take all necessary actions to honor the agreement (provide necessary information, list bonds, etc.)

Negative covenants

(actions the issuer refrains from doing because they would impair the agreement)

- “pari passu”: prohibits a debtor to subordinate creditor’s rights
- “negative guarantee”: prohibits the issue of new secured debt without having secured the debt of the creditor at issue
- others

Trusts provide for solutions to problems

- ***Acceleration*** **clause: makes the bond immediately due and payable**
- ***Deceleration*** **clause: reverses *acceleration***
- ***Cross-default*** **clauses: if a third-party bondholder is not paid, a creditor may trigger contract clauses**
- **Other more specific clauses**

The trust establishes possible amendments to the agreement

- **Amendments *not modifying* the payment terms of the bond**
  - **If governed by New York laws, plurality is needed**
  - **If governed by London laws, 75% of votes is needed**

- **Amendments *modifying* the payment terms of the bond**
  - **Both jurisdictions require 75% of votes**
  - **One monetary unit = 1 vote (if two or more currencies, exchange rate will define number of votes)**

Trusts are more effective against "holdouts"

◆ Trust bonds are not subordinated to other debts incurred by sovereign states.

◆ Trust clauses promote collective actions, because they force bondholders to file claims as a group in case of payment problems. They ensure fairness.

◆ Legal independence of assets necessary to honor obligations from the sovereing state. Prevents seizures.

Trusts are more effective against "holdouts"

◆ However, cases so far have been relatively small. The Argentinean case is testing the efficiency of public debt trusts. Many innovations are expected.

- Over US$23 billion in "holdouts" so far
- More than 140 outstanding legal actions
- Many jurisdictions involved

"Holdouts" in recent debt restructurings

	Amount (millions of US dollars)	acceptance %
Russia	775	98%
Ecuador	197	97%
Ukraine	16	99%
Uruguay	110	98%
Argentina	19.518	76%

Source:El Cronista newspaper on data from MVA and the Argentinean Ministry of Economy. March 2005.

Trust Control

- Now that trusts are being used by Govenments, it is necessary to create arrangements for their internal and external control

- This would make it easier to evaluate trust performance, clearly define responsibilities, schedules and target performance.

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End of presentation