

Trusts and Public debt

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I - Introduction

The debt of emerging countries has been growing exponentially since the mid-70s, giving rise to a series of deep payment crises that have transformed the nature of such debt and made participants develop different mechanisms to cope with successive difficulties.

This is what happened in Mexico, Southeast Asia, Russia, Brazil and Argentina. Within this context, the Argentina of the end of 2001 and early 2002, undergoing a crisis of such characteristics, signed a trust agreement with the Bank of New York.

The shift from syndicated loans in the 80s to bonds in the 90s has changed the dynamics in the relation between creditors and debtors, as well as the way payment problems are resolved.

Within this reality, at the end of the 20th century, a group of countries began facing payment problems and, following the recommendations of the Group of Ten (G-10)¹, based on the changes in the international Financial System with respect to Public debt, they started to use trusts in their renegotiations.

In order to understand the environment and the main reasons underlying the Trust Agreements used in recent public debt swaps, we should first understand the concept of trust, the parties involved and most common characteristics and uses of trusts. Then, we would have to review the development and problems of debt in emerging countries, to set the context for the application of these agreements. Finally, we should focus on public debt trusts, pointing out their main characteristics, to then analyze the specific situation of the Republic of Argentina as a witness case.

II - Trusts. Concept, parties and most common uses

II-1. Concept

A trust is an agreement whereby one person conveys to another the ownership of certain assets, so that such assets are allocated to a given purpose. Within this generic concept, there are two clearly defined aspects: one, conveyance of ownership of assets, and two, a mandate of trust.

¹ In fact, it consists of eleven members: Germany, Canada, USA, France, Italy, Japan, United Kingdom, Belgium, the Netherlands, Sweden and Switzerland. The first seven countries make up the G-7.

This legal arrangement has no purpose in itself, but rather it is a vehicle suitable to provide greater security to a given obligation. The acquirer receives certain assets that are kept segregated from the assets of all other parties in the business and from the recipient's own assets.

The legal effect of this conveyance is to create a new estate with the trustee, to be then referred to as trust property or equity.

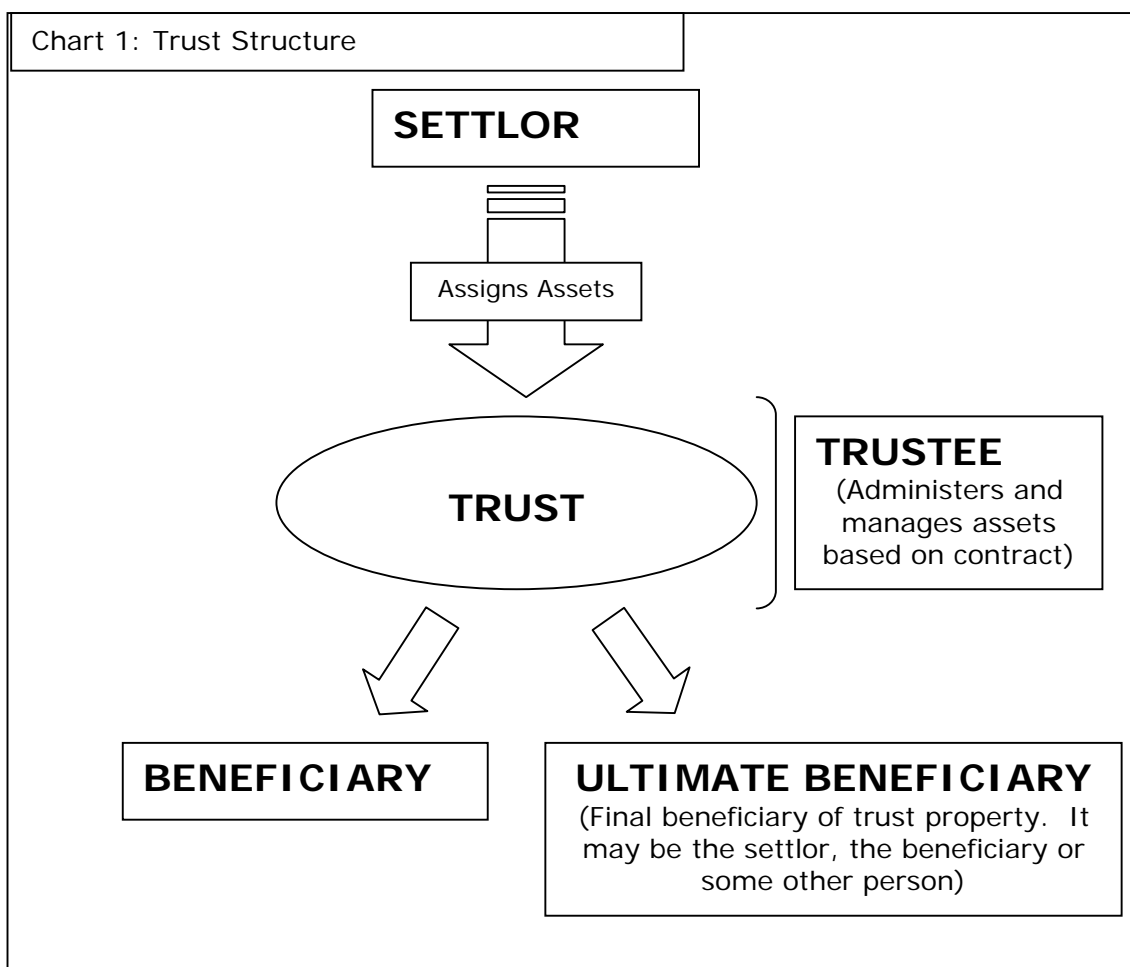
II-2. Parties to the contract

There are two necessary parties: the **Settlor** (or creator or grantor or trustor), who is the person that transfers the assets, and the **Trustee**, who acquires –receives- the assets in trust. They are the parties to the contract. There are other two parties intervening as third parties with an interest: the **Beneficiary**, who will collect the benefits from the trust property and the **Ultimate Beneficiary** (*Fideicomisario*), who is the final beneficiary of the assets held in trust and may be the same person as the beneficiary. These four parties must be either individuals or legal persons.

II-3. Trust Features

A trust consists of a transfer of assets from one party (settlor) to another (trustee), which assets must be identified in the contract or, should that not be possible, the contract must include a description of their requirements and characteristics.

The trustee receives the Trust Property, which includes both title and trust property, that is to say, things (personal or real property) and immaterial or incorporeal objects subject to a value (claims, intellectual rights, trademarks and rights in general).



The Trustee, as recipient, cannot be equated to a person usually acquiring title to the asset subject-matter of a conveyance. There are two types of ownership: unconditional and conditional ownership.

Unconditional ownership bears three characteristics: it is exclusive (which assumes that no two people may each have ownership over “the whole” of one asset); it is perpetual (meaning it survives regardless of its exercise) and is absolute (meaning it is a right related to tangible property that grants the maximum possible authority to the holder thereof, who may dispose of, use, own and encumber the assets within the limitations set by the law).

Conditional ownership, is also exclusive and thus, trust ownership also possesses this characteristic. However, the remaining two characteristics of unconditional ownership are not found in trust ownership.

II-4. Most Common Uses of Trusts

II-4.1. Background

Trusts began to be defined in England in 1850, with the Anglo-Saxon being the first definition of a trust.

This old trust is linked with public trusts, because they were originally created for charities. Charities were the appointed beneficiaries of the trust estate and since they were forbidden by law to own any asset, charitable trusts were created to channel donations in favor of third parties through a trustee. The trustee could accept or not the appointment by the settlor, who, in turn, had the purpose of conveying an asset to a person. They pursued a general common interest purpose, as observed nowadays.

II – 4.2. Financial Trusts

The first thing to point out is the difference between private and public trusts.

In the case of public trusts:

- a) they are created, modified and terminated by a rule that makes them viable: an Executive Order or a law
- b) the Government must necessarily intervene in its creation as settlor.
- c) the segregated estate consists of the State's assets or rights.
- d) the purpose of the trusts is of public interest
- e) their content is the allocation of government funds or the transfer of assets under the State's public or private ownership
- f) the reasons for their creation may be varied and will depend on each specific case, but they always pursue the same purpose: public interest.

Financial trusts are trust agreements where the trustee is a financial institution or organization specially authorized to act as financial trustee, and the beneficiaries are the holders of share certificates (*certificados de participación*) related to trust ownership or holders of debt securities to be paid with trust property.

The beneficiaries are investors purchasing securities backed by the assets transferred in trust. Please note that beneficiaries will be identified once the rights embodied in the securities to be issued are exercised, because of the intrinsically circulating nature of these securities.

Since it is one of the types possible within "general trusts", the terms of issuance of share certificates or debt securities should be stated, thus preventing having to identify the beneficiaries (a requirement of general trusts that is inconvenient for financial trusts).

The generic contents usually include the following:

- a. Identification of trust
- b. Identification of the assets subject-matter of the agreement. If such identification is not possible when the trust deed is executed, such deed shall include a description of the requirements and characteristics of such assets
- c. Applicable law and jurisdiction
- d. Description of how other assets may become part of the trust property
- e. Term or condition to which the trust property is subject.
- f. Use of trust property upon termination of the trust
- g. Rights and duties of the trustee and procedure to replace the same, if necessary.
- h. Identification of settlor(s), trustee(s) and ultimate beneficiaries, if any
- i. Procedure to liquidate the assets, in case they are insufficient to honor the purpose of the trust.
- j. Trustee's rendering of accounts to beneficiaries
- k. Compensation to be paid to Trustee
- l. Terms and conditions for the issue of share certificates and/or debt securities

Bearing in mind that any issue of publicly offered securities includes the preparation of a prospectus (the basic document through which the public offer of securities will be channeled), the following shall be considered conditions for the issue:

- Identification of issuer
- Securities to be offered (type, number, currency and par value)
- Brief description of the characteristics of the securities being offered, describing creditor's rights and applicable law and jurisdiction
 - Risk rating and domicile of rating agency
 - Price and underwriting period
 - Payment terms
 - Self-regulated exchange in which securities will be listed
 - Name and address of underwriting agents.

II-4.3. Other common trusts

Even when flexibility is in the nature of any Trust, in addition to the one described above, the following are the most common trusts:

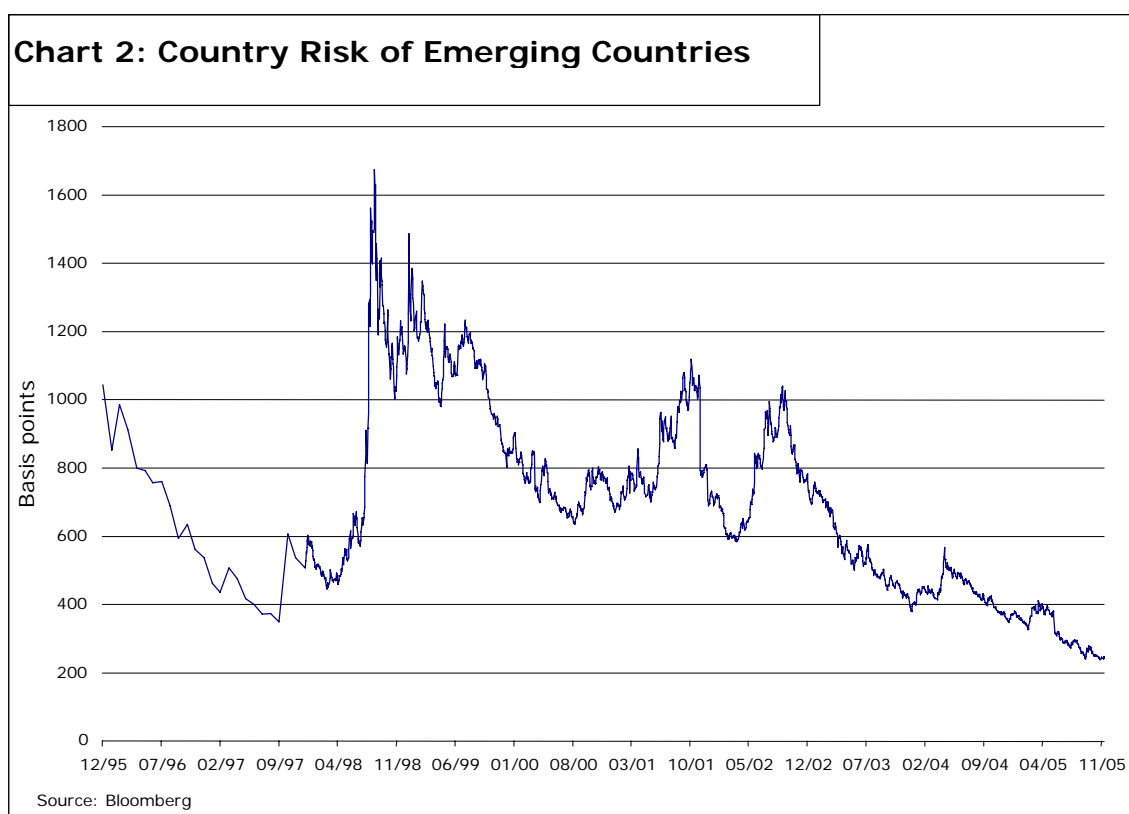
- Guaranty trust
- Insurance trusts
- Real estate trusts
- Government trusts

For the purpose of developing the concept of trusts with public debt, it is first necessary to understand the evolution of the arrangements used by countries facing a crisis for debt restructuring.

III- Holdouts of public debt and possible solutions for recent defaults

III-1. Volatility of emerging countries

The debt markets of developing countries have been characterized by recurrent crises. Due to various reasons, it may be observed that volatility was widely spread in the 90s, which evidences that the risk implicit in debt instruments issued by emerging countries has always been high and, consequently, it affects both the price and interest rate charged by investors. This is how markets take into account the possibility that a given country, at a certain point in time, may show financial distress and fail to pay to then restructure its debt under new conditions, typically less convenient for bondholders.



III-2. Solution to crises in the 80s

As a result of the increases in oil prices in the 70s, oil producing countries accumulated a large amount of US dollars that, added to the huge restructuring of the commercial banking industry in the United

States, substantially expanded the global supply of credit in the international financial system at reduced interest rates. At the same time, the return and strengthening of monetary ideas in emerging countries resulted in a stage of economic openness. Thus the stage was set for these economies to significantly increase the issue of both private and public debt.

Three players participated in the indebtedness process: creditors, debtors and multilateral organizations. On the part of creditors there was a clear willingness to lend, requiring less collateral than in the past. At the same time, debtor countries were becoming rapidly indebted, without calculating their actual possibilities of maintaining a long-term sustainable debt scheme, while international agencies, like the IMF and the World Bank, encouraged developing countries to enter international financial markets without taking added precautions beyond the final use made by debtors of such loans.

At a certain point in time, the abundance of funds started to diminish, which led to a crisis. Both real and nominal interest rates began climbing, while the US dollar appreciated against other currencies. In this scenario in the early 80s payment problems started to come up one after the other.

To find a way out of the crisis, various players, particularly the countries in the G-7, the IMF and some banks of considerable size, organized an international lender of last resort (a role that was played by the IMF) to facilitate cooperation between debtors and creditors. The international lender of last resort contributed to coordinating the renegotiation between hundreds of creditor banks and each debtor country. The purpose was that debtors might carry out a tough contraction adjustment in their economies as a means to avoid a default in debt service that could destabilize the international financial system. The path to normalization would not be easy and represented a heavy burden for almost all the economies involved, which suffered a deterioration of a large part of their economic and social indicators during the rest of the decade.

Once relations between creditors and debtors were normalized, putting an end to a cycle of continuous rescheduling, emerging economies regained access to financial markets.

Thus emerging countries returned to global capital markets, and a new lending boom began in 1991 - although this time bonds became the instrument of choice. The change in the type of financing obtained by countries, when compared with the 80s, is the countless universe of almost anonymous participating investors, compared with the syndicated loans granted by banks in the 80s.

The new financing scheme features the following actors:

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

III-3. Difficulties to restructure debt with bonds and recent solutions. Holdouts, Exit Consents and CACs.

The shift from bank loans to debt bonds resulted in two major problems for countries willing to restructure their debt. The first problem relates to the identification of bondholders, since bonds are traded in secondary markets where investors are counted by the hundred of thousands and are anonymous. The second problem relates to coordination across investors, to speak with a single voice about the renegotiation terms².

Recent experiences show that the first problem was solved by implementing a voluntary bondholder registry and setting the requirements for the identification of creditors before they can exercise their rights.

The second issue generated a many more problems to be solved because the debtor country must unify the opinion of the bondholders to be repaid. Bearing this objective in mind, countries generally make a proposal to swap defaulted bonds for new bonds that reflect the country's opinion, qualified as unilateral.³ This solution becomes complicated when a bondholder, or a group of bondholders, does not accept the terms of the swap. Since no debtor can force a bondholder to accept the proposal, there is the problem of the holdouts. A holdout is a bondholder who by rejecting the swap proposal, "remains outside" of the restructuring to then file legal actions with the purpose being paid his dues as originally agreed.

To settle the conflict, the best option for all players should be considered. Within this scheme, a group of holders of defaulted bonds who are not satisfied with the terms of the swap proposed may decide not to accept it and resort to the courts to claim payment of the total amount of the debt. If a majority of bondholders accept the new instruments, which have a financial structure that improves the debtor's payment ability, the holdouts would be in a better position to collect their

² In principle, this would not happen if bonds included Collective Action Clauses (CACs). These clauses have just started to be included, so that most bonds did not take them into account for renegotiation.

³ In fact, it is not extremely unilateral, because several previous talks are held with experts to make a "reasonable" proposal to bondholders.

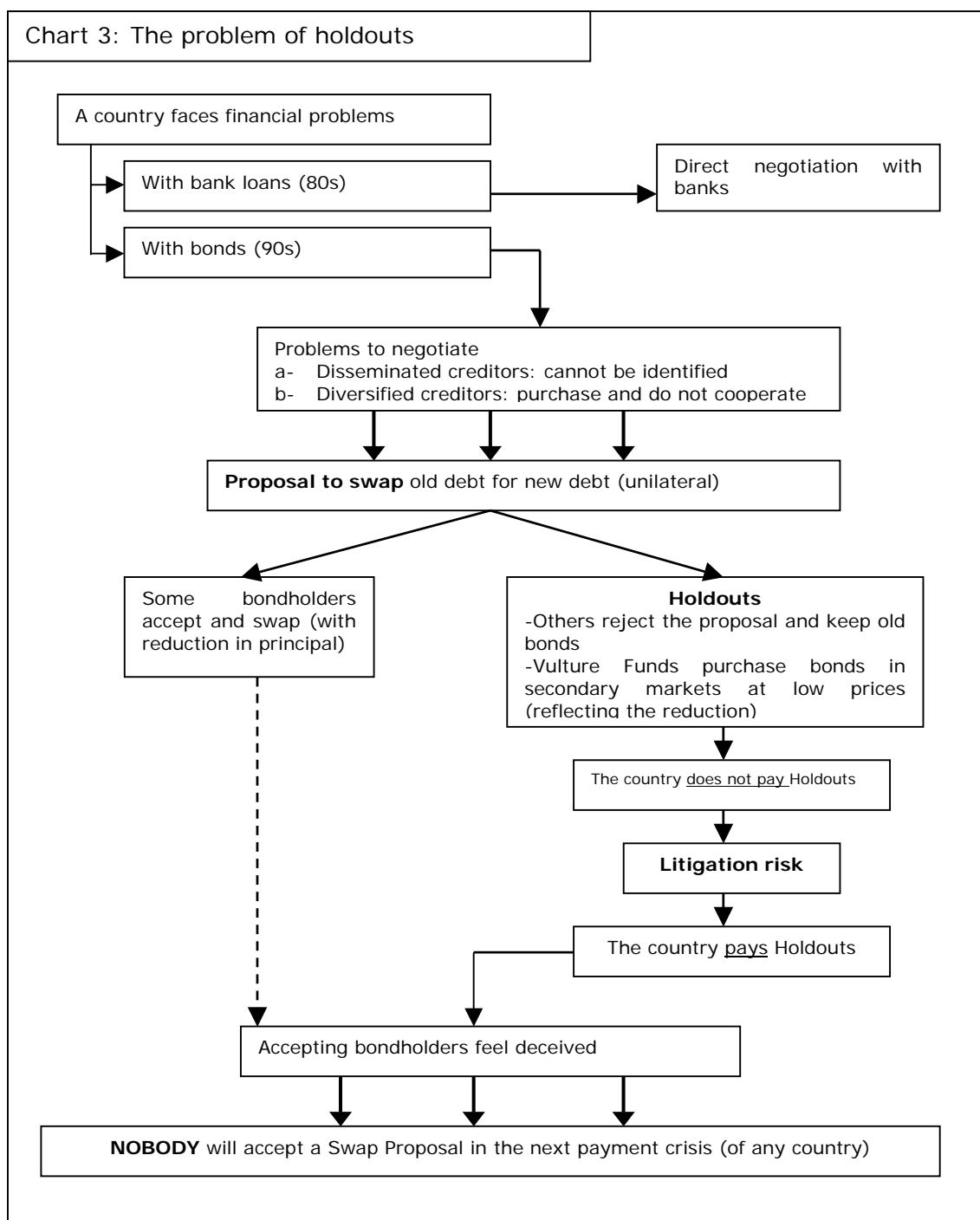
dues. But this would be to the detriment of the bondholders that accepted the restructuring, since the improved payment capacity of the country might result from lower payments derived from a reduction in the amount owed and longer repayment terms in the new bonds swapped for the old defaulted bonds. Therefore, cooperation, so that everybody accepts the swap proposal, is the best solution for all bondholders.

But from an individual perspective, being a holdout represents an extraordinary benefit. For instance, we may point to the case of Elliot vs. Banco Nación de Perú and the Republic of Peru.

Elliot is a widely known vulture fund⁴ that between January and March 1996 purchased a total of US\$11.4 million of bonds issued by Banco Nación de Perú, secured by the Republic of Peru, that were in an irregular situation. In October 1996, Elliot rejected the swap proposal made by Banco Nación de Perú and filed a lawsuit in the State of New York. The District Court rejected the complaint, because the plaintiff had purchased the bonds to file a suit and that behavior violated the law of the State of New York. However, the Court of Appeals set that decision aside and acknowledged Elliot's right of action for US\$55.7 million, and Elliot tried to seize the payments of interest on Brady bonds to be used in the swap. In that case, Elliot filed a complaint with the Commercial Court in Brussels to prevent Euroclear⁵ from accepting or paying interest, on behalf of the Peruvian Government, on Brady bonds.

⁴ These are investment funds specialized in buying distressed debt and acting as holdouts to get a higher yield.

⁵ Euroclear is a system to settle domestic and international instruments in the European market. It is the largest of the world in its kind.



Even when Elliot did not win the lawsuit, the Court of Appeals in Brussels granted a restriction order that hindered the payment of the restructured debt. Peru, faced with the need to complete the restructuring of its debt, decided to pay Elliot in order to be able to use the Brady bond coupon in October 2000. The case gave more incentives to vulture funds to reject swap proposals when governments do not have sufficient liquidity available. There are two outstanding facts in Elliot vs. Peru. The first one is that Judicial Courts of Appeal do not take into account the intention of plaintiffs, that is, it is not the same as in the case of the laws of New York, which prohibit purchases aimed at litigation. The second fact is that sovereign governments may be subject

to seizures, as shown in this case with regards to payments by Euroclear of coupons under Peruvian Brady bonds.

When there are payment difficulties and countries present a proposal to swap defaulted instruments for new instruments, the problem of holdouts arises.

One way to solve such problem is to seek a higher acceptance for the swap proposal. There would be two ways of achieving that goal: either new bonds are made more attractive or the existing bonds less profitable. A third way out would be a combination of the former two.

The difficulties with the first option are that the debtor does not have enough money to make the new bonds more attractive, because it is having problems to honor payments. The second option, aimed at reducing, with the purpose of eliminating, the problem of holdouts is to increase the number of bondholders accepting the swap, known as "Exit Consents".

The strategy is based on the sovereign State, and a large number of bondholders, changing the existing bonds by removing from them what holdouts consider attractive, i.e. the new bonds should include clauses that restrict payments to bondholders who have not joined the swap. In this way, a large portion of what, at first, might have been holdouts, would accept the proposal for faced with the fear of not collecting anything. The method has been considered "coercive". The first country that applied it, characteristic of corporate finance, was Ecuador in 2000, with successful results.

The technique works in the private sector, because the risk of bankruptcy pushes bondholders and management to find a solution to liquidity problems.⁶ But in the case of sovereign debt, the principle that countries do not fail "seduces" such countries to enter into strategic "defaults" to restructure their debts. This is why courts are stricter in the application of the rules.⁷

One of the alternatives that developed in the latest restructuring schemes, and is being increasingly used, is the inclusion of Collective Action Clauses (CAC). These clauses establish that, in case of difficulties to pay debt, a country may propose a restructuring to its creditors. If two-thirds of the creditors agree, the restructuring applies to the rest of

⁶ In the USA, if a company liquidates its assets due to bankruptcy, many creditors (smaller creditors, in general) are frequently affected at the same time that corporate officers are fired. In these cases, these two groups generally ally with each other and file a proposal to restructure liabilities, with clauses granting priority in payment to the new debt.

⁷ In the case of Ecuador, the swap proposal did not reflect this situation but rather the need of the country to restructure its debt. However, the government used this technique to minimize the problem of "holdouts" and vulture funds. Additionally, the US regulation on which exit consents are based, establishes that in this kind of situations, priority is given to the continuation of the company, showing that when this kind of negotiation is accepted, the intention is to solve payment problems, and not to pave the way for abuses.

bondholders. These clauses are added to the bonds when they are launched to the market.

The alternative of including CACs in the new bonds is being recommended by the members of the G-10⁸ as a means to solve the payment problems of non-developed countries. Consequently, both the number and volume of bonds including this type of clauses is rapidly increasing.

Chart 4: Emerging Countries Bond Issues

	2003				2004				2005	
	I	II	III	IV	I	II	III	IV	I	II
W/CACs										
number of bonds	9	31	10	5	25	19	19	15	18	39
nominal value of bonds (in billion US\$)	\$ 5,60	\$ 18,00	\$ 6,40	\$ 4,30	\$ 18,50	\$ 15,90	\$ 10,70	\$ 9,10	\$ 22,30	\$ 35,10
W/O CACs										
number of bonds	14	4	7	7	2	1	1	4	0	1
nominal value of bonds (in billion US\$)	\$ 8,10	\$ 2,50	\$ 3,50	\$ 4,20	\$ 1,50	\$ 0,10	\$ 0,20	\$ 2,70	\$ -	\$ 0,30

Source: International Monetary Fund

IV-Debt Restructuring Trust

IV-1. Why is a Trust Used?

There are two ways in which bonds may be internationally placed: a) using a Fiscal Agent, or b) using a Trust Agreement. The legal effects of these two means are very different.

The Fiscal Agent is hired as agent for the issuer and has no obligation to bondholders. Its main function is to pay the interest and principal commissioned by the issuing State, under the agreement. It may also, as the representative of the issuing State, publish information about payments, etc.

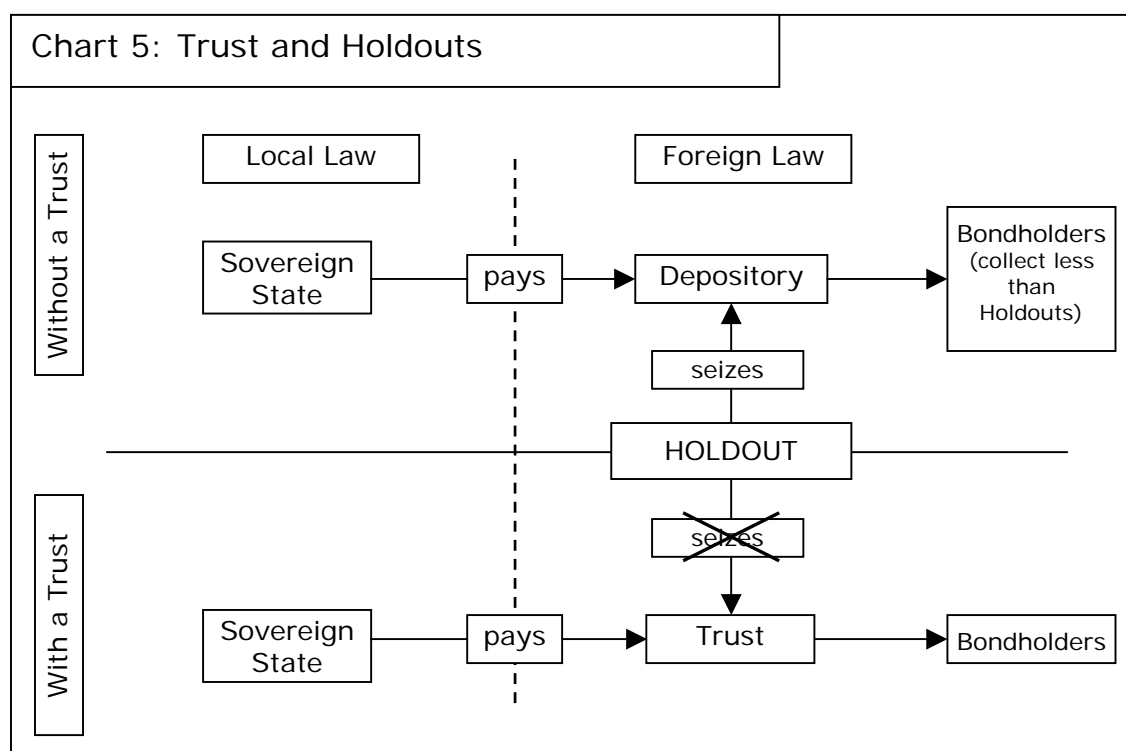
On the other hand, a Trust Agreement is an agreement between the issuer and the trustee, and the beneficiaries of such trust are the holders of debt securities. The trustee must represent the interest of bondholders and, to that effect, it has certain powers to "force" the issuer to care for said interest.

Due to competition among underwriters to lower debt-underwriting costs, trusts have been temporarily replaced by fiscal agents. But, as mentioned in the preceding paragraph, the evolution of the negotiations of recent debt swaps resulted in the problem of holdouts, and the

⁸ In May 1996, the work of the Rey Group was published. It concluded that the inclusion of clauses in sovereign bonds might (a) provide collective representation of the bondholders in case of a crisis, (b) let a qualified majority vote to change the terms and conditions of the bond agreements, and (c) share fairly the amount received from the debtor. In 2003, the Quarles Group presented a work including CACs models.

increasing use of CACs has renewed the attractiveness of trusts for new bonds, offering greater guarantees to debtors.

Additionally, trusts prevent vulture funds from seizing payments. This is because trust assets are independent of settlor –a sovereign state-, thus securing collection by beneficiaries.



The use of trusts is convenient in two senses, because they offer bondholders the possibility an easy coordination among themselves (a single bondholder cannot file a legal action without the participation of the trust) and they encourage communication between debtor and creditors.

IV-2. Public debt trusts

Since the most important international markets to issue public debt are the USA and the UK, the trusts created by a series of countries for recent debt restructurings do not differ among themselves in substance.

A trust agreement involving public debt includes a series of solutions to be applied if the agreement is not honored, as well as procedures to amend the agreement.

Among the duties assumed by the debtor when signing a trust agreement, there are positive covenants, which are basically related to repayment of principal and payment of interest on time. Additionally,

the debtor ensures it will take all necessary actions to honor the bases of the agreement, such as, provide any information necessary to creditors, list bonds in certain exchanges, etc.

On the other hand, negative covenants relate to the actions a debtor refrains from, because they would impair the foundations of the agreement and, thus, the value of the bonds. The most widely known negative covenants are the *pari passu* and the "*negative guarantee*" clauses.

The *pari passu* clause prohibits that a debtor subordinate the rights of creditors, for instance, by reducing their rights in comparison with the rights of other creditors. This clause may give rise to interpretation problems, because it might be claimed that payments to official agencies that are not subject to reductions under debt restructuring (or when such reduction is lower) violate the *pari passu* clause.

The second clause, "negative guarantee", forbids the issue of new secured debt without having secured the debt of the creditor at issue, that is, that in case of default, the asset that might have been used as collateral for the first bond, should not be used as collateral for the new instrument.

If obligations are not fulfilled, contracts also provide mechanisms for settlement. The fastest mechanism, in a contract including collateral, is the attachment of such collateral.

Since not all bonds are secured, there are other mechanisms more widely used to force compliance. In case of default, bondholders may apply the *acceleration* clause, consisting of demanding immediate payment of the whole amount of principal and past due interest. In general, 25% of the votes may trigger the clause. But since this safeguard may be detrimental to the rest of the instruments, *deceleration* clauses are also included. These clauses establish that if the payment problem is about to be solved, 50% or 75% of bondholders may vote against the application of the acceleration clause, provided the bond that triggered the acceleration clause is still facing payment difficulties. This prevents legal actions if a solution may be found, and discourages any kind of speculation. However, deceleration only applies as a mitigation for the rigidity of acceleration rules, and does not override them if payment problems are serious.

Default in payment may also trigger the *cross-default* clause. Under this clause, if the sovereign fails to pay another bondholder, a creditor may trigger contract clauses, such as the acceleration clause. This prevents the payment structure of a sovereign from being further impaired if an acceleration clause is triggered, so that instruments that are facing no payment problems may have to face them in the future

based on the reallocation of resources to pay bonds in default. Additionally, it meets the target of acting as a group in case of default.

There are also *amendment* clauses whereby debt terms may be changed by voting. Each trust agreement sets special requirements depending on the legal framework, but they share the essentials.

Issuers, when faced with a likely problem, may call the trustee for a meeting to discuss the possibility of changing the terms of the agreement. The trustee may then call a bondholder meeting to report on the proposal made by issuer and change the terms of the bonds. But, if no quorum is obtained on the first call, the second call shall have a quorum of 25% to approve the proposed amendments. This design is aimed at promoting the participation of bondholders.

Once quorum is obtained, proposals are voted on. Contracts under the US law needs plurality to introduce any amendment, except for changing the bond's payment terms, in which case, 75% of the votes are needed. On the contrary, instruments ruled by English law always require 75% of the votes. Once changes are accepted, they apply to all instruments under the trust.

With respect to amendments to contracts, the debt restructuring by Uruguay was certainly innovative in that respect. It included an *aggregation* clause establishing that in order to change two or more series of bonds, it is not only necessary to have the consent of the bondholders of each of the series, but also the consent of the bondholders of all series. Moreover, the agreement signed by Argentina includes aggregation by jurisdiction and by currency. These new elements act as a limitation to the actions of holdouts, because they need not only the relevant percentage to block the negotiations related to the relevant series, but also because they need the necessary principal to reach the required voting percentage over the total of the series being negotiated⁹.

A trust, as a contractual structure for debt securities effectively protects bondholders from the actions of holdouts and leads negotiations along a path that minimizes further problems.

As mentioned above, the advantage of a trust is that the trustee bears the obligation to pay creditors. The power and the duty to represent bondholders provides a legal structure that eliminates the problem of free-riders¹⁰ and holdouts, because a trust establishes the necessary framework to set clearly the mechanisms to solve problems fairly in case of payment difficulties, and prevent claims from being seized.

⁹ In the case of Uruguay, 33.1/3 of the series or 15% of total debt is needed, compared with 25% usually required in previous cases. This is a strong incentive to deter holdouts.

¹⁰ Free rider is he who takes a share of the benefits without having incurred any costs.

Since most bondholders always accept swap conditions, trusts, as legal instruments, ensure a faster renegotiation process under better terms, thus avoiding the problem of holdouts for the sovereign and for the majority of bondholders. The Argentine case was programmed in that sense.

IV-3. An example of Public Debt Trust. Republic of Argentina

IV-3.1. Trust Regulation and Creation

The public debt restructuring was authorized in March 2002 under the National Budget for that year, by means of Law 25,565, section 6.

The regulations declared the trust agreement an immunity instrument. In this case, the National State, in its capacity as settlor, appointed the Bank of New York as trustee (by EO 1911/2004, section 4) and the bondholders of swapped bonds were named beneficiaries.

When the Trust was created, its purpose was described as follows: "to provide for the issue, in due time, of debentures, bills, bonds or other debt instrument, ... to be issued in one or more series ... to provide, among other things, for the authentication, delivery and management thereof."

Thus the government delegated on the Trust the administration of bonds of new debt –resulting from the swap- under foreign laws.

It must be noted that the first part of the agreement clearly states the spirit of equity among bondholders and the trustee's duties towards them, because the contract is signed by the trustee and the Sovereign. Additionally, the execution of this contract helps prevent potential seizures of future payments.

IV-3.2. Duties of the Trustee

The necessary parties for a trust agreement are the Settlor, the Beneficiary and the Trustee. The Trustee is in charge of executing the mandates of the contract and ensuring that they are fulfilled. Due to its nature, the trustee bears the largest number of functions, which, in this agreement, are as follows:

- Certify new securities (following the instructions included in the Officer's Certificate¹¹).
- Deliver new securities.
- Administer new securities.
- Register the amount of principal of each series of debt securities, the date of issue, any subsequent transfer and change in ownership and the names, taxpayer identification number and address of Holders.
- Receive payment of principal, interest and any additional amount to be paid by the Republic based on the debt securities and the Trust Agreement (Sections 3.1 and 3.2).
- Keep in trust, for the benefit of holders, any monies received under the debt securities and use them to make payments due under the securities.
- Appoint "trust payment agents" to which Argentina may directly send funds to facilitate any payment to be made (Section 3.5, a).
- Require the Republic of Argentina, in case of any delinquency in the payment of principal or interest, to pay the monies due to Holders (Section 4.4, a).
- If Argentina does not immediately pay the amounts owed when so requested by the Trustee, the Trustee is empowered to file, on its own name and as trustee of an express trust, any action or proceeding aimed at collecting any overdue and unpaid amount, as well as to pursue the case until a final judgment or decision is passed, being empowered to seek enforcement thereof against the assets of the Republic of Argentina, wherever they may be located (Section 4.4, c).
- Act as representative for the Bondholders of one or more series in any proceeding filed in relation to such one or more series of bonds, without the need of becoming party to the proceeding. (Section 4.4, e)
- Notify Bondholders any Event of Default (late payment, failure to comply with other obligations, delinquency declared by the

¹¹ Officer's Certificate means, depending on the context, a certificate signed by the relevant Authorized Representative or Representatives of the Republic of Argentina.

Republic of Argentina, any objection to the validity of the debt securities of any series).

- Appoint a temporary chairman for the Bondholders meeting (Section 9.4).
- Select Debt Securities to be redeemed, if the Republic of Argentina is willing to exercise its right to redeem. (Section 10.3)

However, it should be pointed out that both Argentina and the trustee might, without bondholders' consent, change the bonds of any series with the purpose of:

- Waiving any right or power granted to Argentina;
- Protecting the bonds based on the requirements of such securities or other securities;
- Curing any ambiguity or else correct and supplement any imperfect or unclear provision in the securities;
- Modifying any issue related to the new securities when Argentina and the trustee consider such modification will not impair the interests of the holders of such securities.

IV-3.3. Registration, Certification and Delivery of Bonds

In order to fulfill its aim, after reaching the agreement the State issues the debt bonds and delivers them to the Trustee who will certify them and hand them over to Depositories. Thus, Trust benefits will only attach to duly certified bonds.

The Trustee is to establish a Corporate Trust Office. In this office, the Registration Agent will keep the books where the change of ownership of Debt Bonds will be entered. Registration will include the amount of principal of each series, the date of issue, the transfers and changes of ownership, etc.

As the aim of this agreement is to manage the new instruments, the State agrees that whenever it is necessary by virtue of the debt bonds issued it will pay the Trustee the funds required which "will be kept in trust by the Trustee for the benefit of the Bondholders entitled thereto and the Republic will hold no interest whatsoever in said amounts," up to the "Date of Payment." These amounts comprise the principal and the interest as well as "the additional amounts," which include all the payments of commissions, tax seals, government contributions of any nature and any others "as necessary for...

(bondholders) to receive the amounts of principal, premium and interest that they would have received if such a withholding or deduction had not been demanded," subject to some exceptions. In order to effect the payments, the Republic agrees to keep a "Payment Office." Besides, in order to facilitate payments, the Trustee can appoint payment agents at the Settlor's expense.

IV-3.4. Default

The agreement also considers the "events of default," in relation to the debt bonds of each series, in case any of the following circumstances arise:

- i- Delinquency in Payment: when the Republic is more than 30 days late in the payment of the principal and/or interest of any series of bonds; or
- ii- Noncompliance with Other Obligations: when the State fails to meet one or more of the other obligations within 90 days after notice from the Trustee; or
- iii- Reciprocal Clause in Case of Default: in the face of any event or condition leading to acceleration, except for advance payment, or to delinquency in the payment of principal, premium or interest on the Argentine foreign debt arising from restructuring in a principal amount equal to or above US\$ 30 million; or
- iv- Moratorium: if the Republic declares a moratorium in the payment of the principal or interest on the Argentine foreign debt after restructuring; or
- v- Validity: if the Settlor objects to the validity of any bond of any series.

Should an event of default occur, bondholders having 25% of the whole series in trouble can notify the Settlor that the bonds belonging to that series are due and payable and, after notice, the same will become immediately due and payable. This is where the *acceleration clause* appears. It should be noted that in the face of a minor payment problem, a holdout or a group of holdouts having 25% of the principal can implement a strategy for their own benefit, for instance by gathering only US\$ 25 million in case of a US\$ 100 million series. It can also be observed that the occurrence of an event of default is clearly defined.

Besides, the Trustee can demand the payment of debts on behalf of the bondholders and "can file claims based on this Trust Agreement." This is where the Trust shows a second virtue by comparison with the fiscal agent, because apart from the fact of providing a wider legal protection for payments, the Trustee is bound to defend bondholders. Furthermore, a strategic advantage stands out in the event of financial

distress which consists in the automatic cartelization of bondholders under the figure of the Trustee.

Bondholders under the Trust undertake to refrain from filing claims against the Trust or the parties thereto except in case the Trustee shows lack of action, lack of willingness or noncompliance with its obligations. This represents an indemnity clause for the Trustee in the event any problems arise with investors.

IV-3.5. Collective Action Clause

The Trust sets forth the “provisions governing bondholders meetings”. The purpose of these Meetings is for holders having debt bonds of any series to introduce any amendment in the Trust or in the conditions attaching to one or more series of bonds.

Bondholders (or their agents) can be called to a meeting to be held at a place and on a date specified beforehand, or their consent can be requested. Meetings can also be called at any time or from time to time by the State or by the Trustee and, in the event of default, by “Bondholders having at least 10% of the total amount of principal of Outstanding Debt Bonds of any series who have requested a meeting from the Trustee.”

Every Bondholder is entitled to one vote per every US\$ 1 of principal or, in the case of a series denominated in another currency, to one unit of said currency. In case holders of two or more series denominated in different currencies are called to a meeting, the New York rate of exchange into US\$ dollars will be used to reach a uniform denomination.

Unless the meeting is called to deal with a Restricted Matter¹², quorum will be established by the majority of the amount of principal represented and, in case the necessary quorum is not established, this will be formed by 25% of the votes on a new call. However, if the meeting is called to deal with a Restricted Matter, the quorum required will be equivalent to 75% of the votes.

After defining the steps to call meetings, the procedure is established to modify the Trust Agreement or the conditions attaching to one or more Bond Series.

Any modification pursuant to these terms “will be irrevocable, definitive and binding on any further holders of said Debt Bond.”

¹² The Annex states the meaning of this term under the Trust.

Thus, the new debt bonds governed by foreign law (New York and England and Wales) resulting from the 2005 debt restructuring include mechanisms for their modification and thus prevent, in the event of a payment crisis, the bond negotiation difficulties that arose in the 90s.

Here you will find, as we have seen above in relation to typical cases, how Trust amendment clauses are implemented. In the first place, requirements are established to call a meeting, once again stressing the trustee's right to call it directly. Then, a simple majority is required to form a quorum and, in case this is not obtained on a first call, only 25% is required to call a meeting on a second call.

It can also be observed that, once the conditions to call a meeting have been defined, the necessary votes are established to approve amendments. Once again, typical cases are followed by proposing different majorities depending on whether the questions relate to modifying bond payment terms (in which case they are restricted matters) or not. Besides, the aggregation clause can be found under b) and, taking into account that the new bonds resulting from Argentine debt restructuring include different currencies, currency aggregation is included. Following the rule imposed by Uruguay, 85% and 33^{1/3}% majorities are also required.

IV-3.6. Supplementary Trust Covenants

Another issue established by the agreement is that the Settlor and the Trustee can enter into trust covenants supplementary hereto, which can be:

- i- A Supplementary Trust Covenant Without the Bondholders' Consent: this can be entered into between the Republic and the Trustee for any of the following purposes:
 - a) to increase the Republic's commitments for the benefit of Bondholders, or
 - b) to waive any right or power granted to the Republic, or
 - c) to secure debt bonds, or
 - d) to solve any ambiguity or to correct any defective provision, or
 - e) to perform any minor change of a technical nature, or
 - f) to modify debt bonds or the agreement in a way not affecting the Bondholders' rights.

- ii- A Supplementary Trust Covenant With the Bondholders' Consent: in case a modification is approved at a meeting, the Republic and the Trustee can enter into a supplementary trust covenant to change or eliminate any provisions in the original Trust Agreement.

Once the supplementary trust covenant modifying the original Trust Agreement or the debt bonds involved has been entered into, these bonds will become and will be deemed modified and amended accordingly. Besides, if necessary the Trustee can request new bonds from the State.

IV-3.7. Trust Termination

If at any time the Republic has made available or has paid the principal and the interest accrued, including any additional amounts, over all the debt bonds of any series or delivers to the trustee all the debt bonds for their settlement, or in case all the debt bonds not delivered to the Trustee for their settlement become due and payable within the term of one year and the State has deposited the amounts to effect their settlement, then the Trust Agreement will be deemed terminated. Prior to this, all the necessary expenses will have to be duly paid for.

V- Conclusions

As external debt payment crises have succeed one another, the financial architecture becomes better defined.

The problem with holdouts caused adverse reactions against them from international finance players. One of such reactions was the use of public debt trusts. This legal instrument is one of the best tools available to prevent the speculative actions of a reduced number of bondholders during the restructuring of the external liabilities of any State.

The functionality of trusts derives not only from the fact that they prevent seizure of payments, but also from their nature because they balance, as a result of the atomization of bondholders, the power of bondholders when sovereign governments face financial distress. The trustee has duties to the beneficiaries and not to the settlor, unlike the fiscal agent, whose duties are to the debtor. Additionally, because of their flexibility, trusts facilitate coordination with bondholders and speed up renegotiation proposals.

However, the efficiency of trusts is just starting to be tested, since the participation rate in the restructuring of external liabilities has always been high, with a relatively low number of holdouts. The Argentine case is putting public debt trusts to the test, because there are still 20 billion dollars in distressed debt that have not been settled and over 140 legal actions filed in various jurisdictions so far. This contributes to the challenge of having to effectively cope with holdouts, because the size of the unsettled debt leads to extreme positions. Many innovations are expected in this sense¹³.

	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 based on data from MVA and the Argentine Ministry of Economy. March 2005.

Due to the development of trusts, the number of which doubled in less than two years in both the public and private sectors in Argentina, the establishment of surveillance mechanisms (one internal and another

¹³ It is important to remember that after the fall of the Berlin Wall 1989, the International Financial Community retroactively collected from Russia the debt Communism had rejected throughout its existence.

ex post and external) is considered appropriate. These mechanisms would, in principle, have the same characteristics observed in decentralized government agencies.

This type of arrangement would facilitate any evaluation of the operation of the trust, allowing for a clear delimitation of responsibilities, scheduling and achievement of goals and even a valuation of costs.

Internal control agencies would be an integral part of the trust structure and, among their actions, we may mention the following: promoting an improved management of the institution, investigating and determining the administrative responsibility of the Executive Board; reviewing, surveying and monitoring the management and application of public funds within the framework of the typical audit tasks; monitoring compliance with objectives and the management of basic strategies.

On the other hand, external control would aim at checking compliance with legal provisions, scheduling and budgeting of public trusts, their corresponding registration and evaluation of the composition of management and financial indicators, supported by reports produced by internal audits.

All these monitoring activities should be exercised without losing sight of the objective that trustees are not just executors of what is commissioned by Governments, acting as simple agents, but they are managers and they have duties and powers to be evaluated in the light of preserving the trust property and assurance of funds availability, without deviating from the purpose for which the trust was created.

In the case of public debt trusts, we should also add the impossibility of seizing funds, because of the independence of the trust property.

Additionally, it would be useful to implement mechanisms to follow up the trust property in case of trusts created with a specific purpose of public interest, since, even when the property is equitably owned by the beneficiary, assets come from the National Treasury and their use must therefore be monitored.

This is not applicable to public debt trusts where, in principle, the intervention of the settlor ends when the trustee has discharged the duty it has assumed, that is, the conveyance of assets to the beneficiary.

Mexico, one of the most experienced states regarding trust regulation (it has been developing trusts for almost eighty years), proposes basic elements of analysis for audits that should monitor this *sui generis* contracting practice.

Mexico promotes the creation of a Trust Registry, where the following information should be filed:

- Origin and purpose
- Mandate: who will manage the trust: Trust delegate or Technical Committee or Board and their responsibilities
- Renewal: if it should be extended for more than one term, contractual provision so specifying
- Termination: register the term of the trust, as well as the application to delete the same from the Trust Registry

It also includes a proposal to create Manuals of Procedures including Operation and Control guidelines.

The latter point deserves special attention, since although some countries do not have complete rules for the creation and operation of public trusts, they have shown that, by taking some elements from private law, they have been able to lay the basis for the elementary legal relations: settlor-trustee-beneficiary.

It should be understood that Argentina has approved a budget for this fiscal year of Arg\$3,680,530,083.-, distributed in 16 trust funds, benefiting areas so different as Education, Planning, Economy and Infrastructure, among others.

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