

Sovereign Debt Management Forum 2014

Summary Note for Breakout Session 8

Legal Aspects of Sovereign Issuance in International Capital Markets

I. Summary of session

In this breakout session, legal trends in international capital markets and key issuer choices were discussed. The session was moderated by Cliff Frazier, Chief Counsel of the Corporate Finance Practice Group of the World Bank and it was divided into two stages. In a first stage, two experts in the field delivered comprehensive presentations: Whitney Debevoise, Partner at Arnold & Porter LLP, presented on the legal issues and choices for sovereign issuers, while Anna Gelpert, Professor of Law at Georgetown University, presented on recent developments of sovereign debt contracts. In a second stage, these presentations were followed by three commentaries from the perspective of issuers, made by Sergio Chodos, Executive Director for Argentina of the International Monetary Fund, Stefan Nanu, General Director of the Treasury and Public Debt Department of Romania, and Mr. Jorge Alberto Mendoza, Deputy General Director of Debt Issuance of Mexico. At the end, there was a short Q&A session.

II. Key insights from presentations and discussion

Mr. Debevoise delivered a comprehensive presentation on legal issues and choices faced by sovereign issuers. Although his primary focus was on new issuers at the international markets, he covered topics that are also relevant for issuers that have already been in the market as well as for regular issuers. The main topics covered were (i) local law foundation; (ii) choosing the market; (iii) selecting governing law; and (iv) dispute resolution.

Whitney started by arguing that although the local law foundation is fundamental, it is an element which is sometimes neglected. The institutional structure for the authorization of borrowing, the actual process of borrowing itself, the procurement of services, and the organization of disclosure were the main elements discussed within the foundation of the local law. The institutional structure is usually composed of provisions in the constitution of the country and legislation below that (such as public debt law or a fiscal responsibility law).

According to the presenter, it's also important to focus on the interplay between the executive branch and the legislative branch. He emphasized how having a shelf registration can give the country enough

flexibility so as to take advantage of windows of opportunity and surprise the market as compared to the situation where the legislative branch has to approve each individual operation.

Still on the foundation of the local law, there is the question on how specific the legal authorization process should be. Mr. Debevoise argued that it may not be a good idea to hardwire the financial terms at the legislation, as part of them will be market driven. The same idea can be applied for the use of proceeds, where more general purposes, like budget support, are most common among issuers.

Whitney called the attention, particularly for first time issuers, to the procurement of services and the number of different agents that may be involved in an international issuance, such as rating agencies, financial advisers, investment banks, legal advisers, fiscal agents or trustees, the listing agent, the clearing system, and the international exchange for listing. He particularly discussed the choice of legal advisers (where is not uncommon to have an outside legal advisor, the attorney general, and the government lawyer jointly acting) and the choice between a fiscal agent, who is an agent of the issuer, and trustees, who are representatives of the bondholders.

Regarding the organization of disclosure, he highlighted that besides keeping and publishing good quality statistics, the DMO has to have good coordination mechanisms in place to be able to timely collect all information needed for the due diligence process.

The different structures (Regulation S, Rule 144A, SEC Registered, Shelf Registration, GDNs) to access the market were also discussed. On the one hand, the choice of the market depends on what set of investors the issuer wants to reach. On the other hand, Mr. Debevoise emphasized that although a structure like the Reg S or Rule 144A is easier (cheaper and faster to execute for the first time), the debt management office (DMO) should have a medium-term view as a structure like the shelf registration (or MTN program) gives the country enough flexibility to take the market by surprise. Medium-term cost savings would more than compensate the initial higher costs of such a structure.

On selecting the governing law, the key aspect would be to look at the target market, and avoid the 'home bias' of selecting the governing law where the legal adviser is located or following what neighbor sovereigns are doing. He argued that the differences between the New York and UK law are not that material that would dissuade one country to go one way or the other. He added that, having a look into the medium-term, countries should consider the New York law.

A key message from Whitney to issuers was that the lawyers are, or should be, an integral part of their team. The lawyers should be engaged very early in the process and issuers should allow them to develop institutional knowledge, what may not happen if a different lawyer is hired for each different transaction.

Anna Gelpert talked about some very recent developments on sovereign debt contracts. Firstly, she provided a rich overview on how the collective action clauses (CACs) evolved since their discussion by the G-10 working group in September 2002 and the its first use by Mexico in 2003. The CACs became

standard in bond documentation, being present in the majority of issuances over the last decade. Following the Euro area crisis, the European Union agreed on standardized and identical CACs to be included in all bond documentation starting in June 2013. Ms. Gelpern also described the recent discussions on CACs following the Argentinean litigation and the model clauses suggested by the International Capital Markets Association (ICMA).

Also in light of the Argentinean litigation, the ICMA discussed and suggested modified *pari passu* clauses that would avoid the interpretation given in the Argentinean case. Furthermore, the ICMA also suggested some additional features to the legal documentation as provisions for the formation of a committee and a collective enforcement mechanism. Ms. Gelpern mentioned some of the recent sovereign issuances in the international markets (Kazakhstan, Ethiopia, Vietnam and Mexico) and pointed out which new features or modified clauses they adopted.

Sergio Chodos commented on the recent and on-going litigation case of Argentina. He argued that although most issuers do not think that they will ever go into a restructuring and focus only on the direct or short-term financial cost of the transaction, proper legal advice is essential to set the country's own set of legal and contractual protection. Mr. Chodos also highlighted how important it is to try to protect the country from potential remedies imposed by the courts.

Stephan Nanu drew on Romania's experience as an issuer in the international markets to say: (i) that as an European country they agreed to have the common European CAC approach, especially since Romania have a target date to the adoption of the Euro; (ii) that it seems a consensus among issuers that the ICMA model for the *pari passu* clause is beneficial for everyone; and (iii) that Romania haven't adopted the new modified clauses yet as they are under a MTN program documentation, but will do that when updating the MTN documentation next year. He also shared Romania's experience in moving from a simple 144A stand-alone transaction to a shelf registration (MTN program) as the country became more frequent in the international market.

Mr. Jorge Mendoza provided Mexico's perspective on the discussion of collective action and *pari passu* clauses. Mexico was the first major emerging market issuer to promote these changes in its US SEC documentation and issue an international bond under the new provisions.

At the Q&A session, it was discussed whether the introduction of the new clauses would add a premium to the cost. The perception from the participants was that once the market has accepted such clauses, there would be no additional costs to use them, as it was also the case when CACs were first used by Mexico and Brazil.

III. Conclusion and issues for further discussion

As the discussion on new collective action and *pari passu* clauses is still on-going, it would be interesting to continue to discuss new development in future fora, such as the Government Borrower's Forum. In

particular, it would be interesting to learn from countries their experiences in issuing under the new documentation.

The general discussion on legal issues and choices was very rich and could be a topic for a knowledge product as it is a type of knowledge that is not easily found or accessible for a first-time issuer in the current literature.