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Economic risks and rewards for first-time sovereign bond issuers since 2007

(Update on June 15, 2017)

- Back in 1989, the Brady Plan enabled developing countries to extricate themselves from a solvency crisis that had severely hampered their growth throughout the 1980s. Under the Plan bank loans to these countries were exchanged for bonds with lower face values and longer maturities. The success of the Plan marked a turning point for middle-income countries (MICs). They started borrowing less and less from banks and raising more and more funds on international bond markets.

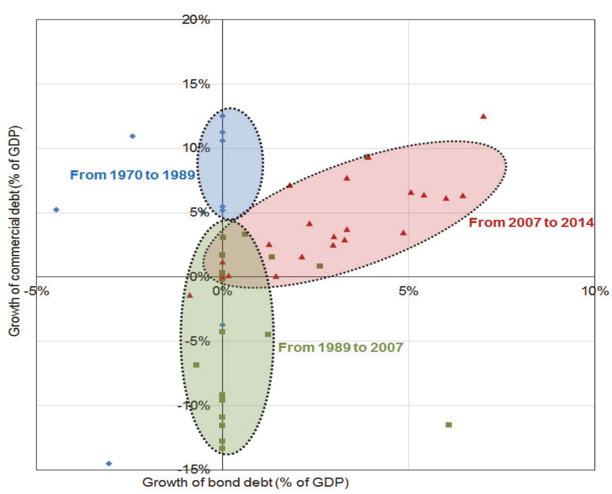
- However, the least developed countries (LDCs) were not part of this trend for some time. It was not until after 2000, and 2007 in particular, that the LDCs gained access to foreign bond financing, as a result of a global economic recovery, combined with rising commodity prices and investors' growing appetite for high yields.

- Twenty-six low- and middle-income countries were deemed to be first-time issuers on international bond markets between 1 January 2007 and 31 December 2015. Their issuance over the period consisted of 85 bonds for an amount of USD 58.7 billion. This amount grew substantially between 2013 and 2015, since 64.4% of the total issuance amount was issued during those years.

- The individual economic and financial circumstances of first-time sovereign issuers may vary, but their bonds are generally subject to major exchange rate risks and refinancing risks. In addition, the settlement that Argentina reached with holdout funds on 29 February validated the holdouts' strategies and made the outstanding bonds of any country in financial trouble more vulnerable.

- Work published by the International Monetary Fund (IMF), the International Capital Market Association (ICMA) and the Institute of International Finance (IIF) after October 2014 made it possible to include clauses in bond contracts that provide better protection against holdout funds' actions and ensure efficient and rapid restructuring processes. Nevertheless, a large share of the first-time issuers' outstanding bonds is not protected by most recent clauses. Furthermore, even though first-time issuers seem to have adopted modified *pari passu* clauses and collective action clauses with menus of alternative voting procedures, clauses designed to coordinate private noteholders' actions are not yet in wide use.

First-time sovereign issuers' debt from 1970 to 2014



Source: World Bank.

Key: The vertical axis shows commercial debt growth in points of GDP. The horizontal axis shows bond debt growth in points of GDP.

MINISTÈRE DE L'ÉCONOMIE
ET DES FINANCES

1. The Brady Plan opened up international bond markets to developing countries

In 1973, the members of the Organisation of Petroleum Exporting Countries (OPEC) decided to cut back their oil production, leading to the first "oil shock" which had very negative consequences for the international macroeconomic environment. At the same time, interest rate caps in the United States[1] spurred American banks to develop an international banking market. This gave rise to a rapidly growing "Eurodollar market", which was open to developing countries, especially middle-income countries. The oil shock led to a fourfold increase in the price of oil. The resulting inflation drove down real interest rates, as the global economy slipped into recession in 1974. These developments undermined the terms of trade for middle-income economies and their current account balances suffered. The middle-income countries' balance of payments deficits grew at an average of 196% per year between 1973 and 1979. This increased their borrowing needs, which coincided with the flow of dollar-denominated capital to the OPEC countries, as the value of their oil exports soared[2]. These funds were deposited with American banks, increasing the lending capacity of the Eurodollar market[3]. Banks offered variable-rate[4], medium- and long-term syndicated loans. Between 1973 and 1979, developing countries funded their balance of payments deficits with commercial loans, and, more specifically, loans obtained on the Eurodollar market. **The commercial debt of middle-income countries increased by 255% over this period.**

In 1979, two events exacerbated developing countries' new reliance on commercial lending: a fresh oil shock and the "Volker shock". The oil shock drove up the price of oil[5], and the "Volcker shock", resulting from month-to-month control of the monetary base, led to variations and major volatility in the value of the dollar, which ultimately soared[6]. The sharp increase in interest rates and the appreciation of the dollar greatly increased developing countries' debt service[7], just as they were suffering from capital flight[8]. Developing countries increased their bank borrowing to cope with liquidity problems and to meet their interest payments. The commercial debt of middle-income countries increased by 22% between 1979 and 1982, despite worsening economic and financial conditions.

Box 1: **The Brady Plan**

A total of 18 countries benefited from the Brady Plan[a], including 11 Latin American countries. According to the IMF, the stock of bond issued under the Brady Plan stood at USD 197 billion in 1997.

At the end of the 1980s, banks recognised their loans to developing countries as impaired assets that no longer produced any income. This made it possible to exchange these loans for assets that offered more security for creditors and lower costs for borrowers.

The Brady Plan called for exchanging bank loans against bonds with longer maturities. As an incentive for lenders to exchange their loans, the government issuing a Brady bond had to buy zero-coupon American Treasury bonds with par values equivalent to those of the bonds issued. These US Treasury bonds, which were financed by international financial institutions, provided collateral for the banks

The specific characteristics of the bonds were defined using a menu of options. Brady bonds took five different forms, even though some other structures were also used on occasion.

Table 1: Bond features

Bond Type	Par bond	Discount bond	Front-loaded interest reduction bond	Debt conversion bond	New money
Type of coupon	Fixed or stepup	Floating	Step-up, then floating	Fixed, floating or step-up	Floating
Interest collateral	For a specified amount	For a specified amoun	For a certain period of time	Not collateralised	Not collateralised
Principal repayment	Bullet	Bullet	Amortising after a grace period	Amortising after a grace period	Amortising after a grace period
Principal collateral	Collateralised	Collateralised	Not collateralised	Not collateralised	Not collateralised

Sources: FED, Salomon Smith Barney.

a. Argentina, Bolivia, Brazil, Bulgaria, Costa Rica, Côte d'Ivoire, Ecuador, Jordan, Mexico, Nigeria, Panama, Peru, Philippines, Poland, Dominican Republic, Uruguay, Venezuela and Vietnam.

Mexico's Minister of Finance announced that his country would no longer be able to meet its debt burden in August 1982[9]. The following year, 40 countries were in the same situation. An international financial assistance programme for developing countries was implemented to overcome what was seen as merely a liquidity crisis. Between August 1982 and 1989, the Paris Club creditors signed 33 rescheduling agreements with 16 of

(1) Under Regulation Q of the Glass-Steagall Act.
(2) Their oil revenues rose from USD 70 billion in 1974 to USD 128 billion in 1977.
(3) In 1978, approximately USD 84 billion of the funds invested in the Eurodollar market came from the OPEC countries.
(4) Two-thirds of the developing countries' debt carried variable rates linked to the LIBOR.
(5) The price of oil jumped from USD 14 to USD 35 between 1978 and 1981.
(6) The dollar rose by 11% against the yen and the German mark, and by 17% in 1982.
(7) In the middle-income countries, it increased by 72% between 1979 and 1982, rising from USD 50.43 billion to USD 86.71 billion.
(8) Mexico, Argentina and Venezuela alone saw withdrawals of USD 70 billion between 1979 and 1982.
(9) At the time, Mexico's total debt at the time stood at USD 80 billion.

the 18 countries that would ultimately benefit from the Brady Plan. The total amount of debt rescheduled for these 16 countries came to USD 73 billion. Commercial banks also had to reschedule their loans to developing countries, while the IMF lent the borrowing countries the funds they needed to meet interest payments in exchange for the implementation of structural reforms. These actions failed to solve the crisis, which was really an insolvency crisis for developing countries. It was not until 1989 that Nicholas Brady, the American Secretary of the Treasury, proposed forgiving a share of the developing countries' debts and exchanging their remaining bank loans for rescheduled bonds, as part of a plan to restore the beneficiaries' financial sustainability that still carries his name. (see Box 1).

2. The number of first-time issuers on international bond markets increased in the 1990s and then posted exponential growth in the following decade

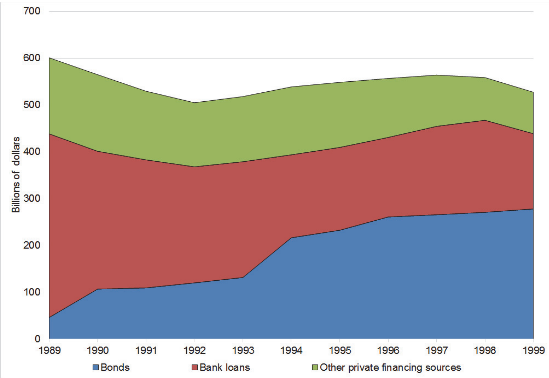
2.1 Developing countries had a growing capacity to borrow as a result of a favourable macroeconomic and financial environment during those years

1. **Commodity prices rose.** The commodity price index, excluding oil, rose by 52% between January 2000 and December 2015[10], and the price of oil increased by a factor of 5.3 between January 2000 and July 2008. The index remained high until July 2014, despite a dip between 2009 and 2011. This meant that developing countries and the least developed countries, which are generally heavily dependent on commodity exports, saw major GDP growth resulting from rising prices. Emerging economies posted average growth of 3.75% in the 1990s and 4.75% in the following decade.
2. **This growth phase coincided with increasing financing needs and fiscal revenues that made it possible to sustain rising debt service costs.** Growth relies on major investment in energy and transport sectors at a time when some countries are emerging from the low-income category and seeing declines in the concessional financing granted to them.
3. **The American Federal Reserve's nominal interest rate reached historic lows:** it stood at 1% in December 2003, rebounded slightly, and then remained at virtually zero after the 2008 crisis. Private investors' interest for developing countries, and the least developed countries in particular, increased because their risk perceptions improved and they sought higher yields in the face of persistently low real interest rates in the advanced economies. Sustained growth in developing countries and the least developed countries enabled them to build up large foreign exchange reserves. Many of these countries also received debt relief[11] that improved their debt-to-GDP ratios.

2.2 The resulting financing demand has increasingly favoured international bond markets, rather than syndicated bank loans

Developing countries seeking financing in the 1980s primarily contracted syndicated bank loans, which had the advantage of involving a small number of counterparties, for limited amounts of financing. Following the success of the Brady plan, the most advanced countries in the group[12] gradually started raising funds on bond markets after 1989. The following figure shows the changing composition of the commercial debt of middle-income countries[13] from the introduction of the Brady Plan until the end of the 1990s. In 10 years, the proportion of bonds in their commercial debt increased from less than 10% to more than 50%.

Chart 1: Composition of the commercial debt of middle-income countries in the 1990s



Source: World Bank.

The trend then spread to a growing number of countries with lower and lower income per capita, until the recent explosion of bond issuance by low-income countries.

Consequently, 26 countries[14] became first-time issuers on international bond markets between 1 January 2007 and 31 December 2015, including 3 low-income countries, 13 lower middle-income countries and 10 upper middle-income countries[15]. The following figure shows the growing share of bond debt in the commercial debt of low-income and middle-income countries after 2000. Middle-income countries' bond debt rose from approximately 50% of their commercial debt to 75% over the period, **whereas, in the low-income countries, the figure rose from 0% to 40% in just two years.**

(10) This refers to the Moody's aggregate commodity price index calculated by France's national statistics institute, INSEE. This index tracks monthly changes (average of observed changes) for 32 imported commodities. According to INSEE, the results are aggregated by the type of product and their use (food or industrial goods). They are denominated in different currencies (euro, US dollars, Australian dollars, Malaysian ringgits, sterling) and in euro."

(11) 36 of the 39 eligible least developed countries have benefited from the Highly Indebted Poor Countries (HIPC) Initiative (see Trésor Economics No. 164, "Will Africa need a new 'Heavily Indebted Poor Countries Initiative'?").

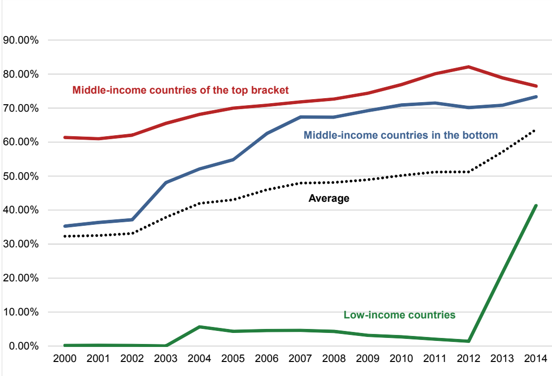
(12) China, Hong Kong, India, Indonesia, Korea, Malaysia, Philippines, Singapore, Thailand, Argentina, Brazil, Chile, Colombia, Mexico, Peru, Czech Republic, Hungary, Poland, Russia, Israel, South Africa.

(13) Includes "lower" and "upper" middle-income countries.

(14) The bond issued by the publicly-owned EMATUM corporation in Mozambique, which carries a government guarantee, was deliberately left out because of its recent restructuring.

(15) Of the first-time issuers, 9 countries receive funds from the International Development Association (IDA), 11 receive funds from the International Bank for Reconstruction and Development (IBRD), and 6 receive transitional support. Of the 9 countries covered by IDA, 4 show a low risk of over-indebtedness, 4 show a high risk of over-indebtedness and 1 shows a moderate risk of over-indebtedness.

Chart 2: Share of bond debt in commercial debt



Source: World Bank.

These developing countries' reliance on bond debt stems from a "conventional" need to finance infrastructure or fiscal deficits. Yet, it is even more instructive to focus on **why they preferred bond debt to more traditional bank borrowing**. At least three reasons can be distinguished:

- **Some first-time issuers chose bonds as a means of financing debt restructuring** (Albania, Armenia, Côte d'Ivoire, Gabon, Kenya and Republic of the Congo), in line with the debt swaps under the Brady Plan.
- **Bond issuance made it possible to raise amounts that could not be accessed through syndicated bank loans,** especially as banks were subject to more stringent prudential constraints. As Table 2 below shows, it is not unusual for developing countries to raise more than USD 1 billion with a single issue.
- **For many first-time issuers, bond issues are an opportunity to register on investors' "radar".** Issuance involves financial reporting, in accordance with accepted standards, and sets a benchmark for corporate issuers, financial observers and rating agencies. This was particularly the case for Angola, Belarus and Nigeria. The IMF believes there is evidence of **"bunching" of issuance in some regions**[16] (e.g. waves of first-time issuance seen in Eastern Europe in 2010, in Latin America in 2012-2013 and in sub-Saharan Africa today). The President of the African Development Bank, Dr. Akinwumi A. Adesina, also stressed the importance of this pattern in African bond issuance in his speech to the 3rd Paris Forum[17] on 20 November 2015. He highlighted the "emulation" of countries imitating their neighbours by issuing Eurobonds[18] in the belief that they would gain a higher profile on international capital markets.

2.3 The typical bond issued by first-time issuers is a dollar-denominated bond governed by English law and issued on the New York market

The 26 first-time issuers discussed in this paper issued 85 sovereign bonds between 2007 and 2015. There were four waves of issues: a first in Eastern Europe in 2010 and 2011, a second in Asia in 2012[19], a third in Latin America in 2013 and a fourth in Africa between 2013 and 2015.

There were 63 such bonds issued on the Yankee Bonds market[20], versus only 19 on the Eurobonds market (2 issuances were made on the South African market, and a last one on the Japenese market). Despite the fact that the vast majority of these bonds were issued on the American market, first-time issuers mostly opted to have them governed by English law (51 bonds), in preference to the laws of the State of New York (21 bonds)[21]. The funds raised are denominated in dollars for 74 of the bonds and in euros for only 6 of the bonds[22].

75 of the first-time issuers' outstanding bonds have not yet reached their maturity. Central governments are the direct issuers of 70 of the bonds and the indirect issuers of 15 of the bonds. In the case of the latter bonds, the issuing entities are corporations governed by private law that are more than 50% owned by the central government (11 of these bonds come from Asian issuers, 3 of them from Eastern European issuers and 1 from African issuers). As of 31 December 2015, only 10 of the 85 bonds selected had been redeemed.

74 bonds are bullet bonds (redeemed at maturity with no intermediate principal repayments), with medium-term or long-term maturities. The bonds may also feature an amortizing structure (11 bonds), or be callable (5 bonds). Following the first such bond issued in Gabon in 2013, several African bonds are structured to amortise over the last three years of their maturity (5 of the 14 African bonds issued in 2014 and 2015 had this type of amortisation structure). The amortisation periods vary in different geographical areas: medium-term bonds were mainly issued in Asia, with mean and median maturities of 9.1 and 10 years respectively, and in Eastern Europe (8.6 and 10 years), while long-term issues were typical in Africa, where the mean maturity stood at around 10.4 years and the median maturity at 10 years, and in Latin America, where the mean was 11.2 years and the median 10 years[23]. The pattern is for these countries to try longer-dated issues as their creditworthiness is established on the markets and the appetite for their bonds increases.

(16) IMF (2013), *First-Time International Bond Issuance - New Opportunities and Emerging Risks*.
(17) The Paris Forum is an annual meeting of sovereign creditors and debtors, including all of the G20 countries, the Paris Club members and countries from different regions of the world. The participants discuss issues related to sovereign debt. The contribution that the Forum makes to international financial dialogue was highlighted in the Addis Ababa Action Agenda signed by the Member States of the United Nations in July 2015.
(18) Eurobonds are bonds denominated in a different currency from that of the market where they are issued. These are often dollar-denominated bonds issued in London.
(19) The year 2014 is excluded since 4 of the 6 bonds were issued by Sri Lanka alone.
(20) Yankee Bonds are dollar-denominated bonds issued in the United States by foreign entities.
(21) The 4 Jordanian bonds guaranteed by the United States are not included; the governing laws of the nine remaining bonds include Japanese law (Mongolia, 2023, USD 275 million), South African law (Namibia, 2020, USD 63 million), Nigerian law (Nigeria, 2017, USD 1.29 billion), and is left unknown in the four remaining bonds.
(22) The remaining four bonds studied were issued in other currencies, namely Japanese yuan, Namibian dollar, South African Rand and Nigerian Naira.
(23) The discrepancy stems from the existence of a 30-year Paraguayan bond.

Most of the bonds have fixed coupons paid semi-annually[24]**.** The coupon rates average 7.3% in Africa, 6.1% in Latin America, 6% in Asia, 7.3% in Eastern Europe and 5% in the Middle East. The average coupon rate in Eastern Europe is very high, matching the average African coupon rate even though the issues in question are medium-term bonds. This could be because more than half of the issuance in Eastern Europe took place between 2008 and 2011.

Table 2 below summarises this information.

Table 2: All bond issuance by first-time issuers on international bond markets since 2007

USD millions	2007	2008	2009	2010	2011	2012	2013	2014	2015
Africa	2266		200	2332	1500	2042	4500	7000	6813
Angola									1500**
Cameroun									750**
Congo (Republic of)	478*								
Côte d'Ivoire				2332*				750*	1000*
Ethiopia								1000**	
Gabon	1000*						1500*		500**
Ghana	750*						1000*	1000*	1000**
Kenya								2750*	
Namibia	38				500*				813**
Nigeria					500*	1292	1000*		
Rwanda							400*		
Senegal			200*		500*			500*	
Tanzania							600		
Zambia						750*		1000*	1250**
Latin America						500	2481,3	1000	
Bolivia						500*	500*		
Honduras							1051*		
Paraguay							930*	1000*	
Asia	500		500	1000	1000	4100	3226	3675	3545
Armenia							700*		500**
Azerbaidjan						500	1000*	1750*	750*
Mongolia						2100*	276		145
Sri Lanka	500*		500	1000*	1000*	1500*	1250*	1925*	2150
Eastern Europe		500		1457	1505	750		300	1017
Albania				407					482**
Belarus				600*	800*				
Georgia		500		250	500*	750*			
Montenegro				200*	205*			300*	535
Middle East				750			1250	1000	2000
Jordan				750			1250	1000	2000**

Countries covered by the HIPC initiative

* With CAC

** With IMF-recommended CAC

NB: 2 issues in the year for the underlined amounts; more than two issues in the year for amounts with a double underscore.

Sources: Paris Club, IMF, Thomson Reuters.

3. Risks and rewards relating to first-time issuers' bonds

The spread of sovereign bond debt to all developing countries obviously raises critical questions about the new risks involved. These risks are easy to understand, in contrast to bank loans, which were the prevalent form of commercial debt until the 1980s. Table 3 summarises the main risks and rewards for first-time issuers:

Table 3: Comparison of issues and risks between bank and bond debt

Type of debt	Market entry cost	Leeway of government in defining financing terms	Risks	Ownership of claims	Restructuring process
Bank loan	Lower: The borrower can easily start negotiations with a bank	Restricted: The borrower accepts the banks' terms	Risk of change, Refinancing risk, Fluctuation risk commodity prices	Concentred ownership by one or more banks	London Club
Bonds	Higher: The issuer must build up markets confidence	Ample: The issuer defines the terms of the bond issue	Risk of change, Refinancing risk, Fluctuation risk commodity prices	Diffused ownership by many creditors	Contractual terms

Source: DG Trésor.

Bonds are powerful financial instruments that can be used to raise very large amounts of funds, given the current market conditions and the quest for high yields. However, the greater possibilities offered by bonds, compared to bank loans, carry a cost, which comes on top of the redemption structure for the bonds and contributes to the **financial risk** that the structure incurs on behalf of the issuer. In addition to the financial risks, there are **technical constraints** owing to the greater level of sophistication of bonds, which requires precise and properly calibrated contract clauses. The technical sophistication stems from the **more diverse range of creditors** with whom the debtor must now interact. This calls for a standard and secure framework, particularly with a view to potential restructuring of the debt, but that topic does not fall within the scope of this paper.

- **A more powerful, more flexible and riskier financial instrument**

The first-time issuers' outstanding bond debt makes these countries vulnerable to exchange rate risk, especially in the case of "bullet" bonds where the principal is redeemed in one payment at maturity. This represents a major gamble on their future ability to repay their debts and on fluctuations between the domestic currency and the dollar. As we have seen previously, this type of bond, which is becoming increasingly widespread, requires the issuing government to

(24) There are 3 floating-rate bonds from the Congo, Côte d'Ivoire and Tanzania.

be able to redeem it in a single payment that can be more than USD 1 billion. This represents a substantial challenge for fragile economies, whereas bank loan repayments were spread out over time. The first-time issuers that are commodity-exporting countries have been particularly hard hit by the decline in commodity prices since 2014. Some of them are already seeing debt service rise more quickly than central government revenue.

Exchange rate risk is another important factor that looms even larger because the **dollar is the dominant currency of issuance**, even though the currencies of many first-time issuers, particularly in Africa, are linked to the euro. This risk was realised, for example, between 1 January and 31 December 2015, when the first-time issuers' currencies depreciated by an average of 14.8% against the US dollar. Depreciation of a first-time issuers' domestic currency leads to (i) an increase in the relative value of the principal to be repaid and (ii) costlier debt service through larger coupon payments.

Even though rising international interest rates may not have an immediate impact on debt service, since only 3 of the 80 bonds under consideration are floating-rate bonds, changes in average coupon payments between 2014 and 2015 show a rising trend: from 6.8% to 8.2% in Africa from one year to the next, and from 5.2% to 6.6% in Asia, and, more moderately, from 5.4% to 5.6% in Europe[25]. Some of the most recent bond issues even show alarming yield levels: with a yield of nearly 10% for Ghana on its latest bond issued in September 2016. **There is little refinancing risk in the short term, but it could increase in the medium term.** Six bonds will mature in 2017: USD 500 million in Azerbaijan, USD 1 billion in Gabon, USD 500 millin in Georgia, USD 750 million in Ghana, USD 600 million in Mongolia and USD 500 million in Sri Lanka.

- **Coping with technical and legal complexity, as well as a more diverse range of creditors who sometimes have antagonistic strategies**

All of the technical parameters mentioned above constitute the first source of complexity when designing bonds. **In addition to paying high yields, issuers have to pay for brokerage fees, insurance and currency swaps, whereas bank loans did not necessarily entail such expenses.** These costs make the issuance of sovereign bonds even more expensive.

But the true technical problem lies elsewhere. The **diffuse structure of bondholding means that, in the event of default or restructuring, issuers could face litigious strategies like those used by "vulture funds" against Argentina.** Creditors may exploit legal loopholes to constitute a blocking minority and go to the competent courts seek repayment of what they feel they are owed, dragging debtors into a costly fight that severely undermines their image.

Not all of the first-time issuers would be able to repay several billion dollars, as Argentina did, if the courts handed down a similar decision against them. The range of countries using bonds to contract foreign debt is very diverse. They represent three income levels on all five continents, with wide variations in their administrative and technical capacities to manage bond debt, as measured by the World Bank's "CPIA" indicator[26]. **The CPIA rating that measures the quality of fiscal and financial management is medium[27] (3.4) for the 16 first-time issuers concerned, and low (2.875) for the African countries.** The score has also slipped slightly, from 3.59 at the time of the first bond issues. **The CPIA rating that assesses debt policy is high for first-time issuers as a whole at 3.9. This is also the case for the African countries, with a score of 3.83.** This score has also slipped from 4.03 at the time of the first bond issues.

The increasing reliance on bond issuance by developing countries spurred international financial institutions, with the IMF in the lead, to propose **contract clauses that provide more robust protection against the action of vulture funds**, which are outlined in Box 2.

Box 2: **Review of the bond contract clauses proposed by the IMF**

The problems encountered during the restructurings of Argentina's bond debt in 2005 and 2010, and of Greece's debt in 2012 made it necessary for the IMF to develop and promote contractual clauses that ensure more rapid and efficient negotiations creditors and debtors in the event of a sovereign default. The IMF proposed two clauses in September 2014[a]:

1. **A collective action clause (CAC) with a menu of alternative voting procedures**[b] offering debtor governments three ways to modify the payment terms: (i) when holders of 75% of the outstanding principal agree, (ii) when holders of more than 66.66% of the outstanding principal agree and when holders of more than 50% of the bond in question agree, or (iii) when 75% of the holders of a given series agree.
2. **2.An enhanced *pari passu* clause,** to avoid the interpretation given by the American court[c] of the original version of the clause stating that creditors are to be repaid in proportion to their amount owed to them, regardless of whether they agree to the restructuring of their claims.

The third clause refers to "bondholder committees". This clause is being promoted by the Institute of International Finance (IIF), and was mentioned by the IMF in 2015[d]. It enables a specified group of private bondholders (holding 25% of debt in the IIF version) to be represented by one or more persons at the restructuring negotiations.

a. IMF (2014), *Strengthening the contractual framework to address collective action problems in sovereign debt restructuring.*
b. The second option is the two-limb voting procedures promoted by the euro area since 2013.
c. New York Court, 7 December 2011 and 23 February 2012 in NML v. Argentina; upheld by the Court of Appeal of the Second Circuit, 26 October 2012 in NML v. Argentina.
d. IMF (2015), *Progress report on inclusion of enhanced contractual provisions in international sovereign bonds contracts.*

(25) Latin American countries and Jordan are not included because they did not issue enough bonds.
(26) The Country Policy and Institutional Assessment is an indicator made up of ratings from 1 to 6 that the World Bank attributes to IDA-eligible countries (countries receiving transitional support are also concerned). The indicator covers 16 criteria grouped into four clusters: Economic Management, Structural Policies, Inclusion and Equity, and Public Sector Management and Institutions. The CPIA rating is used under the Debt Sustainability Framework. It makes it possible to set a threshold at which a Debt Sustainability Analysis is triggered.
(27) A CPIA rating of less than 3.25 is low. A rating of 3.25 to 3.75 is medium and a rating of more than 3.75 is high.

The reception of the IMF proposals published in 2014 varied, depending on the type of clause under consideration.

- **CACs, especially with the menu of alternative voting procedures, were welcomed. Fifty-three of the outstanding bonds, representing approximately 70% of the outstanding amount, include CACs, and 11 of the bonds use the CACs proposed by the IMF. One of the bonds was issued at the end of 2014 and 7 were issued in 2015.** The outstanding bonds of first-time issuers from Latin America also includes 5 bonds with CACs including menus of alternative voting procedures, but the thresholds for applying the voting procedures are different from those recommended by the IMF[28]. Furthermore, 28 of the first-time issuers' outstanding bonds include CACs that do not have an aggregated voting threshold and one bond has a CAC with a two-limb voting structure. CACs with a single-limb voting structure make it possible in theory to "dilute" the position of a litigious creditor, but this is not the case for small issues, where it is easier to acquire a blocking minority position.
- **The IMF recommendations concerning the language of *pari passu* clauses were also followed, but to a lesser extent.** Even though only 13 outstanding bonds have enhanced *pari passu* clauses, the trend is for more enhanced clauses. Eleven of the 17 bonds issued in 2015 had enhanced *pari passu* clauses.
- **Few bonds have clauses with the threshold for the formation of bondholder committees promoted by the IIF:** 23 bond series have this type of clause, but the threshold for applying them is set at 50% of bondholders in 19 cases, including 5 bonds that are no longer outstanding, and at the lower threshold of 25% in only 4 cases. There are 41 bonds that do not have such clauses[29].

The outstanding bonds without enhanced contractual clauses will mature in the medium term. Of the 22 bonds that might not include CACs, 9 will mature before 2020 and 13 will mature between 2020 and 2025. They represent principal of USD 13.5 billion, which break down into USD 6.8 billion in Asia, USD 3.75 billion in the Middle East and USD 1.9 billion in Africa. Of the 60 bonds without enhanced *pari passu* clauses, 27 must be redeemed before 2020, and 29 between 2020 and 2025. The 4 remaining bonds will mature between 2029 and 2044. The outstanding principal of bonds without enhanced *pari passu* clauses stands at USD 37 billion. It should be remembered that the Argentine dispute involved some USD 7 billion in non-restructured bond debt and arose out of a disputed interpretation of a *pari passu* clause.

- **Special attention to countries benefiting from the "Heavily Indebted Poor Countries" Initiative (HIPC)**

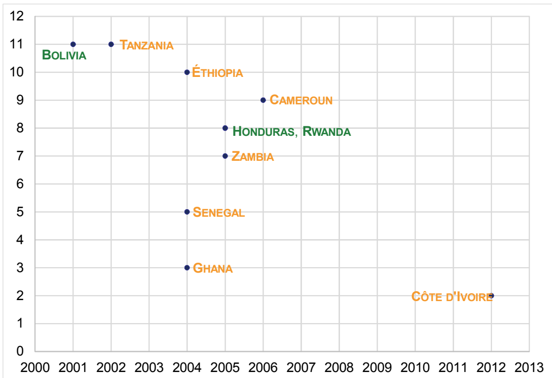
Four of the five geographical areas have countries in them where the ratio of foreign bond debt to GDP is greater than 10%: Africa (Zambia, Côte d'Ivoire and Gabon), Asia (Sri Lanka and Mongolia), Eastern Europe (Armenia and Montenegro) and the Middle East (Jordan). It should be noted that in the case of Montenegro, the country adopted the euro as its currency and systematically issues Eurobonds.

The average figures, however, do not reflect the diversity of countries' individual circumstances, particularly in the African countries that benefited from massive debt relief in the 1990s and the following decade under the HIPC Initiative. In other words, the window of macroeconomic opportunity that opened between 2012 and 2014 spurred **some of the countries that had long since exited the HIPC Initiative to opt for bond issuance, after having established a satisfactory track record. Other countries, in contrast, had just benefited from massive debt relief**.

The 4 countries that succeeded in returning to financial markets most quickly include the three countries with the highest ratios of foreign bond debt to GDP (Ghana, Zambia and Côte d'Ivoire). This can be put into perspective by looking at the two first-time issuers that exited the HIPC Initiative first, Bolivia and Tanzania. These countries have low ratios of foreign bond debt to GDP, standing at 3.0% and 1.1% respectively.

This development is obviously a special cause for concern. It shows that opting to issue bonds is far from being an isolated occurrence. In some countries, it has given rise to a fresh cycle of rapid accumulation of foreign debt with no certainty yet about controlling outcomes.

Chart 3: Number of years between the exit from debt treatment under the HIPC Initiative and the first bond issue on international markets



Sources: IMF, Thomson Reuters.

(28) Four of the five Latin American bonds that have menus of alternative voting procedures with thresholds that are different from those proposed by the IMF were issued before the IMF published its proposals.

(29) In 12 cases, it is not known whether the bonds have such clauses, and the Jordanian bonds guaranteed by the United States are not included.

Conclusion

The sovereign debt landscape has seen many changes since the major debt crisis in the 1980s. The most decisive change is bound to be the growing number of developing countries relying on bond issuance on international markets to obtain financing. Bond issuance was initially limited to the countries benefiting from the Brady plan, but it has spread gradually and now concerns some of the world's poorest countries.

The first-time issuers find there are several advantages to bonds compared to conventional commercial financing in the form of bank loans. Bond issues can raise larger amounts and they are also a way of having the issuing country register on investors' radar, by subjecting them to sophisticated technical standards.

However, these advantages in themselves bring some risks. There is no certainty that first-time issuers, lulled by favourable macroeconomic conditions, have grasped the full measure of the inherent risks of bond issuance. These risks stem from highly compressed redemptions, what is more in foreign currencies, from the high costs involved, and from the complex and unfamiliar language of contract clauses.

The bond contracts governing their outstanding debt could indeed make some of these countries more vulnerable in the event of debt restructuring. On 16 March 2016, Argentina's Parliament ratified a settlement that the government had reached with the holdout funds, validating the holdouts' predatory strategies. Therefore, it is conceivable that such strategies will be used again in the event of an imminent or declared sovereign default. It means that first-time issuers may indeed register on some speculators' radar, but as prey rather than partners.

In the future, therefore, the question will be how the growing stock of such bonds could be included in an orderly restructuring, when the current mechanisms are not necessarily appropriate for them.

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