Sovereign bonds

# Investors brace for new law on sovereign debt workouts

Critics warn it will raise financing costs for developing countries on international markets

David Malpass, who stepped down as president of the World Bank this month, criticised bondholders for failing to take part in a G20 debt initiative © Getty Images for Concordia Summit

**Jonathan Wheatley** 10 HOURS AGO

A law close to approval in the state of New York would force commercial creditors including bondholders to give the same relief as lender governments when developing countries restructure sovereign debts.

Its backers say it would streamline debt workouts — agreements between lenders and borrowers to renegotiate terms following a default — that have dragged on for months or years in countries such as Zambia and Sri Lanka.

It would also stop "holdout" or "vulture" creditors from bringing protracted lawsuits to get a better deal than other lenders.

But its opponents say the bill, which supporters hope will be passed into law before the state assembly term ends on June 8, is misguided and will have the opposite of its intended effect.

They say it will make it more expensive for developing countries to raise finance on international capital markets and open the door to a flood of legal challenges.

Its progress will be watched closely in the UK, where a parliamentary committee has called for legislation to compel private creditor participation in debt workouts. Almost all developing country sovereign bonds are issued under New York or English law.

"This bill is badly needed. We saw that when private creditors held out and refused to come to the table during the pandemic," said Eric LeCompte, head of Jubilee USA, an NGO that campaigns for debt relief for poor countries.

Speaking outside the state assembly in Albany New York, LeCompte said "hundreds" of supporters were there pushing to get the bill through before the recess, against opposition from "vulture funds that are putting in millions of dollars to try to kill it".

Critics of the bill say its attempt to force commercial lenders into restructuring will backfire, despite the strong case for laws to thwart holdout creditors from disrupting restructurings that can stop defaulting countries from regaining market access for years.

They say it has two serious flaws.

First, it will make investors, typically pension funds and other big institutions, less willing to buy the sovereign bonds of developing countries on both primary and secondary markets, making it harder and more expensive for them to finance their development.

Second, its poorly defined terms and scope will be an invitation to litigation by both issuing countries and their creditors.

Leland Goss, general counsel of the International Capital Markets Association, said that while the bill is well-intentioned, it would “hurt the very governments that the proposals are intended to help”.

Deborah Zandstra, of law firm Clifford Chance, said the bill’s drafters should think again. “If I were them I would push it into the next session and undertake some market consultation.”

She said the bill or one like it could serve a useful purpose if it made it harder for holdout investors to gain advantage over conventional bondholders.

Actions brought by holdouts against Argentina after its default on $80bn of debt in 2001 were only resolved in 2016.

Several distressed debt investors made multiples of the knockdown prices they had paid for the country’s bonds, after more than 90 per cent of creditors had accepted 30 per cent of their face value.

But Zandstra argues that this issue has been largely dealt with through collective-action clauses, widely used in sovereign bond contracts since 2014, which make it hard for a minority of creditors to hold up a deal accepted by the majority.

An IMF working paper found that of $1.3tn of foreign law sovereign bonds outstanding in March 2020, just 4 per cent did not have collective-action clauses.

If the bill’s aim is to force conventional bondholders to engage with developing countries in debt distress, Zandstra said, “that problem does not exist. If that’s what’s driving this, it’s misguided”.

Debt campaigners and many others including David Malpass, who stepped down as president of the World Bank this month, have slammed bondholders and other commercial creditors for not taking part in the G20 Debt Service Suspension Initiative launched early in the pandemic.

This enabled 48 out of 73 eligible low-income countries to postpone $12.9bn of repayments to foreign governments due between May 2020 and December 2021.

At least three of the 48 asked private creditors to defer payments under the scheme of which two - Zambia and Chad - defaulted or restructured soon after. The rest refrained for fear of harming their credit ratings and raising their cost of borrowing or losing market access altogether.

The G20's follow-up initiative, known as the Common Framework, obliges participating countries to seek relief from private lenders that is comparable with what they first obtain from bilateral creditors.

But the initiative has gained little traction and only four countries have signed up — Zambia, Ethiopia, Chad and Ghana.

Kevin Daly, investment director at asset manager Abrdn and member of a committee of investors holding defaulted bonds issued by Ghana, said bondholders have been quick to engage.

But they have been able to do so only after bilateral lenders, in many cases dominated by China, have agreed an outline deal.

"We are willing to sit down, we are willing to take haircuts, and to say we are not is completely disingenuous," he said.

*This article has been corrected to clarify that at least three, not none, of the 48 low income countries that deferred repayments to foreign governments under the G20 Debt Service Suspension Initiative also asked private creditors to defer repayments under the scheme.*