Creditor Committees in Sovereign Debt Restructurings: Understanding the Benefits and Addressing Concerns

Timothy B. DeSieno[1]

December 2014

INTRODUCTION

It is not difficult to argue that creditor committees are the single most useful tool for addressing current concerns about sovereign debt restructuring. Sovereign creditors are frequently concerned that restructurings inadequately address their commercial and process concerns, in some recent cases leading to restructurings that impose concessions that unfairly impinge their interests. Sovereign issuers are frequently concerned that their ability to achieve important creditor concessions is impaired when their debt is in the form of widely-held bonds, and real creditors may be hard to identify and to locate for purposes of understanding concerns and preferences. Both constituencies are concerned by what is currently labelled "the holdout problem", which describes the ability of some bondholders not to agree to a proposed restructuring, and instead to seek to collect on their un-restructured claims, potentially disrupting others' agreed objectives.

Many stakeholders and experts are debating how to address these concerns. Proposals range from IMF-required debt re-profiling, to enhanced collective action clauses, to revised *pari passu* clauses, to an independent forum of experts, to a system of mandatory mediation. Each of these ideas has merits and drawbacks, and there would seem to be sense in examining all possibly useful tools.

I contend, however, that most key players in the field are paying too little attention to creditor committees, even though such committees are the tool that has enabled most consistent and effective progress on these concerns throughout the history of restructuring <u>bond</u> debt. Many leading organizations have long advocated the central importance of creditor committees in debt restructuring exercises.[2] There is no reason for any deviation from that viewpoint just because the debt in question happens to have been issued by a sovereign instead of a private entity. The brief outline below may aid in assessing known benefits and means for addressing perceived drawbacks of creditor committees.

---

[1] Tim DeSieno is a partner in the financial restructuring group of Morgan, Lewis & Bockius LLP, contactable at +1 212 705 7426 and tim.desieno@morganlewis.com.

[2] See, e.g., *Orderly & Effective Insolvency Procedures* (International Monetary Fund Legal Department, Washington, D.C.), 1999; *The World Bank Principles for Effective Insolvency and Creditor Rights Systems* (The World Bank, Washington, D.C.), December 21, 2005; and *Statement of Principles for a Global Approach to Multi-Creditor Workouts* (INSOL International, London), 2000.

KNOWN BENEFITS

Committees Streamline a Restructuring Process for Issuers. The formation of a representative committee provides an issuer a credible and user-friendly, single forum in which to make proposals and to advance its interests. If a committee includes representatives of the key stakeholders, and if it is well-advised, the committee can work to build inter-creditor consensus, removing the complexity of that task from the issuer. In addition, consensus is usually speedier via a committee, as most creditors will usually feel they can trust "a group of their own" more readily than they can trust the issuer. This dynamic enables an efficient process that imposes less administrative burden on the issuer. The recent cases of Greece and Belize, while perhaps subject to criticism for other reasons, have demonstrated how committees can form and serve this useful purpose in modern sovereign bond restructurings.

Committees Redress Information Imbalances. A primary reason for creditors to organize in connection with a restructuring exercise is to counteract the natural information imbalance that exists between issuers - who are closely familiar with the details of their own affairs - and creditors , who are not close to the day-to-day governance of an issuer. In order to ensure an issuer shares a universe of broadly useful information, it helps if a representative group of creditors can assemble and agree on what is needed. With that agreement, the issuer can be confident that information requests are targeted and are not overly time-consuming, ad hoc, or designed to gather unnecessary or even strategically harmful information. The mission of the committee is to learn sufficient detail to negotiate a reasonable deal, based on expectations that are as matched as possible with those of the issuer. The best pathway to matching expectations is to match information bases sensibly. Experience with committees demonstrates their efficiency in this work. Again, the recent cases of Greece and Belize, in addition to the ongoing work in the case of Grenada, demonstrate that committees play a constructive role in the informational aspects of modern sovereign debt restructurings.

Committees Enable Confidentiality. As in any debt restructuring exercise, confidentiality is key to a successful sovereign debt restructuring. No stakeholder wants confidential information leaked to the public that could harm the issuer, or that could harmfully affect the progress of restructuring discussions. All stakeholders will understandably be concerned about the risk that discussions with multiple bondholders could lead to information leaks, even in the absence of bad intentions. A committee helps address this risk, first by limiting the number of creditors with whom the issuer shares information. Second, committee members would ordinarily sign a confidentiality agreement that prohibits dissemination of confidential information except via agreed mechanics, using agreed materiality considerations, and at agreed times. These arrangements enable a more robust exchange of information, which in turn enables better matching of expectations, which in turn enables more efficient deal-making.

Committees Enhance Support for Consensual Deals (Minimizing Holdouts). Perhaps the most fundamental benefit of a committee is the weight its views can lend to other creditors' favorable consideration of a proposed restructuring (or of an interim standstill or a temporary payment cessation; if such steps are demonstrably sensible, committees can support their implementation as well, and that support will be more persuasive to other creditors than any *ex ante*, rules-based equivalent). In amassing support for a proposed deal (or other interim step),

and in diminishing the attraction of a creditor holdout strategy, the supportive views of a well-crafted and well-informed creditor committee are unmatchable. If creditors understand that a committee has been close to the design of the proposed terms, that the committee consists of creditors whose interests are the same as theirs - or at least clearly aligned with them - and that the committee supports the proposed terms as being reasonably fair and sustainable in the circumstances, then creditors take enhanced comfort that they too should support the proposal. On the other hand, creditors often suspect that a proposal designed without meaningful and organized input from a committee is more likely to favor those stakeholders who did design the terms, likely impairing the (absent) creditors disproportionately. Such suspicions, especially if reasonably grounded in the publicly available information, can materially enhance the attraction of a holdout strategy. In general, a creditor will select a holdout strategy only if it is confident that its rights otherwise would be impaired disproportionately, and if the holdout strategy includes a cost-effective means for re-capturing some of the lost value. Creditors do not choose a holdout strategy lightly, and the fact of meaningful involvement and support from a demonstrably capable committee makes holding out all the less interesting or attractive.

ADDRESSING PERCEIVED DRAWBACKS

Do Committees Slow Progress toward a Deal? It is sometimes asserted that committees slow progress toward a restructuring proposal. First, there is a fear that a committee can be slow to form as creditors assess how best to advance their interests. In times of crisis, the delay can be damaging. Second, it can take time to engage a committee and to advance the diligence, confidentiality, and negotiating processes that are involved.

On the first point, practical experience is different: creditors are usually ready to organize quickly once it is clear there is work to be done. Often, such an organization forms within hours or days of relevant developments or announcements. If on the other hand, a committee is slow to form, there would be no need for an issuer to slow its efforts. Either way, there is no need to lose time over committee formation.

On the second point, it is important to examine the costs and benefits of the alternatives to a committee. In the absence of a committee, does the issuer plan a series of informal consultations with creditors, and how much time will that effort take, especially if larger creditors require more than one consultation as the process unfolds? But also, how successful would a non-committee process be? If a non-committee process leads to market suspicion and material holdouts, especially if material creditor concessions are proposed, those results will counter-balance any perceived increase in speed gained by declining to engage a committee.

Do Committees Increase the Expense of a Deal? It is sometimes asserted that committees increase the expense of a restructuring deal. Most usually, committees engage expert advisors, financial and legal, to aid them in their work. These advisors come with a cost, and the issuer is asked to bear that cost. Of course, it is difficult to argue with the idea that there is an expense of dealing with a committee. But issuers readily accept this cost in the end, at least when the advisors' work helps lead to a deal that is widely supported by the creditor community, enabling the issuer to achieve its larger goals. The added expense always pales in comparison to the benefit of a successful deal, especially one that follows the best practices of creditor engagement

the IMF, the World Bank, and INSOL International generally advocate. At the same time, it is important that committees' expenses be carefully controlled. In addition to a possible expense-management function of an over-arching body that might play a useful role on this subject (see below), committees themselves are powerful regulators of the expense of the restructuring exercise. Committees know that all stakeholders ultimately bear the cost of any expense, even if the issuer pays. Practical experience shows that committees limit their advisors' roles to their pure areas of expertise, and committees are increasingly in the habit of requiring budgets and cost-efficiency of their advisors.

Do Committees overly Expand Creditors' Power? Some are of the view that a creditor committee may overly strengthen the position of a sovereign's creditors, weakening an issuer's ability to achieve needed creditor concessions. One could surely posit scenarios in which a committee might enhance already-existing power of a sovereign's creditors in ways that could potentially be dangerous. For example, any group of creditors that alone has the power to affect materially new lending to a sovereign might be overly empowered by a committee, which could institutionalize such power. In the era before Brady bonds, for example, when private sector lending to sovereigns was driven by globally-powerful banks, we could imagine a sovereign becoming concerned. On the other hand, in today's world of sovereign bond issuances, and widely-disbursed bond holdings and little if any incentives or mechanics for investors to cooperate "to black-list" any country, we contend any parallel fears are overdone. With the exception of Argentina, about which most investors are agreed further sovereign lending is unwise (in no small part due to Argentina's very decision to advance its proposed restructuring while declining to engage any creditor committees), investment views about any given country can vary quite widely amongst investors in both primary and secondary markets. Investors simply lack the concentrated power that global banking syndicates once enjoyed.

How can Committees Be Supervised? Some have also asked whether it would be possible to standardize and to supervise committee behavior so as to provide comfort to issuers that committees will be predictably constructive. Practical experience indicates that creditors in general are quite effective at regulating their own activities, including in tempering hostile actions against a stressed issuer. Committees tend to behave responsibly toward the objective of maximizing value sustainably in light of the known economic dynamics and constraints.

On the other hand, a creditor committee is by definition an advocate for creditors, and as such issuers might gain comfort from knowing creditor committees have to abide an agreed set of operating rules. It is exactly this idea that motivated our proposed amendment to the IMF's lending into arrears policy on the topic (which is attached hereto as Annex A). The attached document regulates important items such as (a) committee formation and representativeness, (b) the terms on which an issuer is to reimburse a committee's expenses, (c) the means for ensuring the issuer's confidential information remains confidential, and (d) the core operations of the committee, such as refraining from litigation, maximizing speed and minimizing cost, and supporting agreed terms with other creditors. Between creditors' genuine responsibility and regulations such as these, committees would be empowered to serve their core functions of enabling restructuring deals and minimizing holdouts.

Still, it would seem to be sensible to study establishing a supervisory body that would observe issuer-committee restructuring efforts and would assist in maintaining a constructive approach and resolving disputes (e.g., the "Standing Committee" mentioned in Annex A). Anybody that is tasked to do that work must be one that is demonstrably (a) expert in debt restructuring and (b) just as importantly, fully impartial - it cannot be a body that has any current stake in sovereign debt, such as any of the existing multilaterals or the Paris Club or the London Club.

Other Concerns. In a 2009 paper,[3] Lee Buchheit listed a collection of "Potential Drawbacks" to a creditors committee in a sovereign debt restructuring. To the extent not already addressed above, each is discussed briefly below.

- First is a concern that that once a sovereign engages a committee, it is difficult "to divorce" that committee. Aside from the healthy disciplining effect such a limit might have were it to be true, issuers in the past have indeed dis-engaged from creditor committees when the process was insufficient, or unsatisfactory to the issuer. That outcome is not ideal, but declining to get married because divorce is difficult might not be the best reasoning.

- Second is a concern that different constituencies might form committees, and it might be difficult to coordinate them all. Aside from the point that it would be even more difficult to coordinate the multiplicity of creditors without any semblance of organization, there is the well-known mechanic of establishing an umbrella committee, with sub-committees as needed, in order to offer the best streamlining possible.

- Third is a concern is that committee membership may shift over time. Aside from asking why the changing of one or more seats in a committee should be problematic so long as the committee remains representative, it is worth noting this concern is inconsistent with practical experience. Serving on a committee entails material trading limits for a creditor, since a committee member is generally exposed to inside information. A creditor chooses to get on a committee only after carefully considering the impact on its trading strategy, and no creditor changes this decision lightly.

- Fourth is a concern that committee members will misuse confidential information. Aside from asking for examples of bondholder committee members behaving in that way in the current regulatory environment (none have been reported), it is worth noting there is nothing unique about sovereigns that makes this risk any higher than it is in any other context, say in connection with a corporate debtor, where nobody seems to oppose committees.

In sum, each of these concerns can be addressed by stakeholders who desire to do so, as part of a good faith effort to strike a reasonable and sustainable restructuring deal.

---

[3] Buchheit, *Use of Creditor Committees in Sovereign Debt Workouts*, 10 Bus. L. Int'l 205 (2009).

CONCLUSION

Practical experience working with creditor committees over the past several decades affirms their constructive approach, as well as their utility to a good faith issuer that really wants to achieve consensus on a fair and sustainable debt restructuring. Certainly, the committee process can raise concerns, and effort to address those concerns is worthwhile. Standardization and even supervision would seem to be worth exploring. But it is on those topics where the energy of debate should be directed, and not on a continued debate about whether committees should be used at all. Committees are too valuable to the restructuring process, and in time they will be found to exceed any of the other tools under discussion for addressing identified risks and achieving prompt, fair, and sustainable debt restructuring.

A/75973301.5

ANNEX A

OUTLINE OF PROPOSED AMENDMENT TO IMF POLICY ON SUPPORT FOR GOVERNMENTS RESTRUCTURING SOVEREIGN BOND DEBT

1. **General**. No government shall be entitled (a) to restructure its sovereign bond debt and (b) to enjoy any new financial support from the IMF, from and after the date (the "**Commencement Date**") that the IMF first discovers that such government plans or intends to restructure its sovereign bond debt, unless such government shall have fully complied with either the "Committee Guidelines" or the "Publication Guidelines" below. To the extent the IMF's lending into arrears rules are implicated, a government's compliance with these Guidelines shall be deemed to constitute its "good faith effort".[4]

2. **Committee Guidelines**. Unless the government shall fully comply with the "Publication Guidelines" below:

    a. If a single bondholder committee (a "**Committee**") that includes holders not affiliated with the government of at least [25]% of the government's total external bond debt shall not have formed within [__] days of the publication of the Commencement Date, the government may proceed to restructure its sovereign bond debt in any legal manner.

    b. If a single Committee shall have formed within [__] days of the publication of the Commencement Date, the government shall engage and finance (as defined below) the Committee. If the Government believes it would be useful, (using form documents to be designed) the government may finance a meeting of bondholders – or a series of them in the case of multiple bond issues – convened for the purpose of authorizing the Committee to act, although in a non-binding fashion, on behalf of all bondholders in the restructuring discussions. Unless a committee's role shall have been expressly rejected at a quorate bondholders meeting, such a committee shall be deemed to be the Committee for purposes of these Guidelines.

    c. For purposes of these guidelines, "**engage and finance**" shall mean:

        - execute a letter agreement (the "**Committee Letter Agreement**") with representatives of the Committee (using a form document to be designed) containing the government's commitment to work with the Committee toward a consensual deal and to reimburse the Committee's reasonable expenses for so long as the government shall be in discussions with the

[4] Accordingly, these Guidelines will require augmentation so as to include other relevant aspects of the "good faith effort" as already prescribed by the IMF.

IMF, subject to earlier termination upon completion of the bond-related deal;

- provided the Committee engages legal advisors within [__] days of its formation, execute a letter agreement with one legal advisory team (using a form document to be designed) containing the government's commitment to pay the reasonable cost of the advisory team's services;

- either publish all documents in accordance with the "Publication Guidelines" below or execute a confidentiality agreement with representatives of the Committee (using a form document to be designed) committing to share confidential information with self-selected "restricted" Committee representatives for a limited period and committing to publish all shared material nonpublic information on an agreed schedule; and

- timely abide its undertakings in each of the foregoing agreements and negotiate in good faith with the Committee toward a consensual deal that (i) is based on the collection of information that the government has shared with its creditors, (ii) respects contractual rights, (iii) includes and is based on an agreed set of governmental policies and policy reforms, (iv) is designed to match the parties' views of the government's debt sustainability, (v) provides comparable treatment to all types and classes of debt claims, and (vi) is solicited and documented in full consultation with the Committee and its advisors.

3. **Committee Responsibilities**. For so long as the government is in compliance with the Committee Guidelines above, and for as long as the Committee Letter Agreement remains in effect, the Committee shall be obligated to undertake the following actions (which shall be specified in the Committee Letter Agreement):

   a. The Committee shall serve as the representative for bondholders in the restructuring discussion process, cooperating with the government and the other creditors in a good faith effort to achieve agreement.

   b. The Committee and its members shall refrain from litigation or other collection activity against the government, and consistent with market practice, the Committee shall support the government in opposition to the litigation or collection activity of other bondholders.

   c. The Committee shall cooperate with the government in the sharing of confidential information in a manner that assists the Committee in its deliberations, and the Committee shall strictly honor its confidentiality undertakings at all times.

   d. Consistent with market practice, the Committee shall assist the government in attempting to build market consensus in support of any proposals that the government and the Committee jointly support.

e. Consistent with market practice, the Committee shall cooperate with the government in each reasonable way so as to maximize the speed of the restructuring process and to minimize its cost.

4. **Publication Guidelines**. Unless the government shall fully comply with the "Committee Guidelines" above:

   a. The government shall provide to the IMF written permission (using a form document to be designed) to publish on the IMF website (i) every document that the government provides to the IMF from and after the Commencement Date through the date of publication of the exchange offer or equivalent, except to the extent that a confidentiality-bound standing committee of investor representatives (the "**Standing Committee**"), in consultation with the IMF staff, determines that a document is not relevant or material to the consideration of any proposed restructuring terms and (ii) every document delivered to the IMF within the [__] days prior to the Commencement Date that the Standing Committee, in consultation with the IMF staff, determines is relevant or material to the consideration of any proposed restructuring term.

   b. The IMF shall have so published each such document within [__] days of having received such document (or the written permission to publish, if later).