Argentina Debt Crisis and Its Implications for Sovereign Debt Restructuring
With ABI’s Code & Rules:

• Search for a specific provision of the Bankruptcy Code and related Rules
• Access links to relevant case law by section (provided by site partner, LexisNexis®)
• Retrieve a Code section or case summary – even on your mobile device
• Personalize it with bookmarks and notes
• Receive it FREE as an ABI member

Current, Personalized, Portable
law.abi.org
Argentina Debt Crisis and Its Implications for Sovereign Debt Restructuring

American Bankruptcy Institute
Cross-Border Insolvency Program
June 20, 2014

Jim Millstein
CEO, Millstein & Co.
The Path to the Brink

- The Republic of Argentina defaulted twice in the 19th century (1830, 1890) and twice in the 20th century (1982, 2001)
- In 2001 Argentina suspended payments on over $100 billion of debt, at the time the largest default in history
  - In the 1990s an inflexible currency convertibility regime and international credit crises undermined export competitiveness, exacerbated current account deficits, and increased public debt and interest rates
  - In late 2001, the government faced a sharp fall in tax collections and could no longer refinance its obligations through private or public channels
  - It planned a voluntary debt exchange in two stages, the first targeted at domestic residents and the second at nonresidents
  - The first stage was carried out, but in December 2001 the government declared a moratorium on payment of, inter alia, $82 billion in bonds, $10 billion of IMF loans, and $6 billion of Paris Club loans
  - It simultaneously abandoned convertibility and devalued the peso, which reversed its current account deficit but sent public debt to over 130% of GDP in 2002, as much of the debt was denominated in foreign currency

### Graphs

**Public Debt/GDP**
- Source: Bloomberg.

**Current Account/GDP**
- Source: Bloomberg.

---

**Source:** Bloomberg.
One Step Forward, Two Steps Back

■ The first phase of the exchange plan succeeded

- Incentives for domestic participation included the threat of an involuntary exchange and favorable accounting rules for banks and pension funds, which allowed them to carry the new instrument at par rather than marked to market
- In exchange for bonds, domestic creditors were offered loans governed by Argentine law, with a guarantee backed by revenues from a financial transaction tax, and an option to recover the original bonds if loan terms were ever changed
  - Three loans were offered: fixed rate with a lower, capped interest rate and extended maturity; floating rate with similar conditions; and a capitalizing loan with a 10-year maturity
- Nearly all debt held by local banks, pension funds, and other residents was tendered with an average haircut of roughly 40% in net present value, reducing the sovereign's debt service by $26 billion through 2006

■ Negotiations in the second phase were protracted and alienated private, sovereign, and multilateral creditors

- Argentina and independent economists blamed the IMF for imposing misguided conditions and establishing unrealistic economic expectations that contributed to the crisis
- The Paris Club typically requires an Article IV review from the IMF before considering a restructuring proposal, and poor relations between Argentina and the Fund undermined immediate multilateral workouts
- Sovereign restructurings typically target at least 50% of net present value and 90% participation
- Faced with a severe recession and public demands that foreign creditors suffer, government officials felt empowered to force steeper losses on foreign bondholders and in 2003 presented “Dubai guidelines”, attempting a 75% nominal haircut
- A large number of dispersed creditors (~600,000), the absence of collective action clauses, and diversity in choice of law governing the debt complicated negotiations
- After three years of contentious negotiations, Argentina elected to act unilaterally, offering a one-time exchange to private creditors and passing the “Lock Law”, which prohibited the government from reopening the exchange, otherwise offering creditors better terms, and making payments on untendered debt
Slow March to Resolution

■ The 2005 exchange for private creditors

- In January 2005 Argentina opened an exchange, offering creditors holding $82 billion of face value of debt roughly 30% on a net present value basis through par, discount, or quasi-discount bonds and detachable GDP warrants
- Nearly $21 billion of past due interest (PDI) was ignored, which was rare among recent sovereign restructuring events
- Despite the Lock Law, participation was only 76%
- New bonds include New York, British, and Argentine choice of law provisions, depending on the series, and collective action clauses

■ Argentina repaid the IMF in full in 2006

- Eliminated pressure to follow the Fund’s policy prescriptions, but impediments to Paris Club settlement remained

■ The 2010 exchange for private creditors

- Although the economy, fiscal account, and reserves had improved significantly by 2009, Argentina remained shut out of international capital markets and was under pressure to resolve untendered debt
- The government suspended the Lock Law and opened a new exchange in 2010, offering retail investors a par bond, cash for PDI, and a GDP warrant; and offering institutional investors a discount bond, a par bond for PDI, and a GDP warrant
- Although the average net present value haircut was slightly worse than the 2005 exchange, 68% of previously untendered creditors participated, bringing the aggregate participation rate across the two exchanges to just over 91%
An End May Be in Sight

- **Paris Club and IMF**
  - Last month Argentina reached agreement with the Paris Club to repay $9.7 billion in installments over five years
  - It also recently addressed deficiencies in CPI and GDP estimates that had led to IMF censure in early 2013

- **Holdouts**
  - An aggregate of approximately $6 billion of face value eligible debt was not tendered in the 2005 and 2010 exchanges
  - Over three quarters of that is held by institutional investors, largely hedge funds, that continue to pursue legal remedies, with the remainder held by Italian retail investors
  - Holdouts claim principal plus accrued interest and penalties of close to $15 billion
  - In response to legal actions, Argentina recently re-opened the exchange offer on 2010 terms
  - The Finance Ministry appears to have a new mandate to settle claims, but significant acrimony remains, US court decisions have emboldened holdouts, and the two sides are not close in aggregate amount or treatment of PDI
  - Some exchange bondholders have expressed a willingness to help facilitate settlement

- **Other recent settlements may provide momentum**
  - Argentina recently settled significant disputes related to the sovereign’s violation of foreign investor rights in companies that are doing or had done business in the country
  - It settled five arbitration awards by transferring bonds with a market value of 85% of the awards and 55% of PDI, and in return beneficiaries will reinvest 10% of the amount originally claimed and the World Bank will invest up to $3 billion
  - Argentina also recently settled Repsol’s claim in YPF by transferring expropriation-related bonds
The 2005 and 2010 exchanges settled many legal challenges in foreign courts.

However, holdouts have received attachment orders and continue to chase Argentine assets around the globe, thus far unsuccessfully.

- In 2011 the Second Circuit held that assets held by Argentina’s central bank in the Federal Reserve Bank of New York were immune from attachment.

Holdout challenges to the equal treatment provision in the defaulted bonds have proved more successful in the US.

- In 2009 Elliot’s NML Capital filed a claim in the Southern District of New York to enforce the *pari passu* provision in defaulted bonds it purchased in 2008.

- Judge Griesa held that the provision is enforceable and should be interpreted broadly, issued injunctions that require Argentina to make “ratable payments” to holdouts whenever it pays exchange bonds, and ruled that the injunctions covered certain intermediaries in the payment chain.

- On appeal, the Second Circuit upheld the order but remanded to determine what ratable payment means.

- Judge Griesa held that it means payment in full plus interest, and the Second Circuit agreed, dismissing Argentina’s offer to reopen the exchange as an insufficient remedy but staying the injunction pending resolution of further appeal.

- Argentina petitioned the Supreme Court for writ of certiorari in February posing two questions:
  - Whether to certify to the New York Court of Appeals whether a foreign sovereign is in breach of a *pari passu* clause when it makes periodic interest payments on performing debt without also paying on its defaulted debt.
  - Whether the injunction violates the FSIA bar against “attachment arrest and execution” by coercing payment.

On June 16th the Supreme Court denied Argentina’s petition.

In a recently-leaked memorandum Argentina’s counsel recommended default and restructuring if the petition was denied.
Interpreting *Pari Passu*

**The Clause**

“The Securities will constitute … direct, unconditional, unsecured and unsubordinated obligations of the Republic and shall at all times rank *pari passu* and without any preference among themselves. The payment obligations of the Republic under the Securities shall at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness.”

**District Court Interpretation**

- Argentina violates the provision “whenever it lowers the rank of its payment obligations under [plaintiffs’] Bonds below that of any other present or future unsecured and unsubordinated External Indebtedness”
- Argentina lowered the rank of plaintiffs’ bonds when it made payments to the Exchange Bonds without satisfying obligations due to the plaintiffs’, and when it enacted and subsequently suspended the Lock Law

**Alternative Interpretation**

- Argentina cannot discriminate among bonds in the same series
- Bondholders are protected against legal subordination in favor of another creditor
Scope of the Injunctions

- **Ratable payment**
  - Argentina must pay plaintiffs the same percentage of “the total amount currently due” to them (i.e., 100% of the entire amount of principal plus accrued interest) that Argentina pays of the total amount currently due to the exchange bondholders (i.e., 100% of the periodic interest payment)

- **Third parties**
  - Although the injunctions directly bind only Argentina, through the automatic operation of Federal Rule of Civil Procedure 65(d), they also bind Argentina’s “agents” and “other persons who are in active concert or participation” with Argentina
  - The injunctions therefore cover Argentina, the indenture trustees, the registered owners, and the clearing systems, but not intermediary banks and financial institutions receiving funds from the Depository Trust Company

- **Why was there no adequate remedy at law?**
  - Argentina would refuse to pay a money judgment, given the Lock Law and FSIA immunity
Economic Conditions Are Mixed But Do Not Suggest Imminent Default

**GDP Growth Has Improved**

Recent Industrial Activity Has Been Less Encouraging

International Reserves Have Fallen

Debt Remains Low Relative to GDP

Balance of Payments Has Been Negative Since Mid-2012

The Peso Remains Under Pressure

Principal and Interest on Foreign-Denominated Debt Through 2017 Is Approximately US$30 billion
Key Lessons for Sovereign Debt Restructuring

- **Default may be a viable option for sovereigns running a fiscal surplus**
  - Although the near-term economic adjustment from default and abandoning convertibility was painful, fiscal resources were liberated and the pressure to attract foreign reserves was mitigated
  - Fiscal consolidation and a prayer for growth were not effective alternatives to escape a downward spiral

- **Whether a restructuring is orderly can have a material impact on a sovereign’s ability to re-access capital markets**
  - Argentina’s unilateral approach alienated private and public creditors
  - Governance issues continue to impede access to international capital markets

- **Targeting steep discounts regardless of impact on participation can complicate a restructuring**

- **Although collective action clauses can prevent a long tail of potential expensive and disruptive holdout litigation, such clauses are not necessary to achieve a successful sovereign restructuring**
  - An across-the-board moratorium solves the “rush to the exits” coordination problem, and sovereign immunity and fiscal surpluses can buy time to craft a sufficiently attractive package to attract strong participation

- **GDP-linked securities can be significant sweeteners**

- **Ad-hoc committees can overcome dispersion in creditors, but it must have credibility with the sovereign**
  - The Global Committee of Argentina Bondholders claimed to represent over 50% of outstanding private bonds eligible for the 2005 exchange, but the Argentine government never formally recognized it

- **Holding out can be profitable, but it must be patient**
  - Recent success in US courts has driven up prices of untendered US$-denominated Argentine debt
  - Elliott has had success litigating defaulted debt based on *pari passu* provisions, including $58 million on a $20 million investment in Peruvian bank debt and $90 million on $20 million in Congolese bank debt

- **Choice of law can be a material constraint, especially if the US court decision in *NML v. Argentina* stands**
Lessons – How Long Do Markets Punish Defaulting Borrowers?

- Evidence indicates minimal capital market exclusion and temporary, if any, increased borrowing costs following sovereign default

- Greece recently raised €3 billion in five-year bonds at a yield of just under 5% in a heavily oversubscribed issue, only two years after restructuring approximately €200 billion of face value privately-held sovereign debt

Comparing Argentina’s Restructuring with Others Since 1998

### Characteristics of Main Sovereign Debt Restructurings with Foreign Banks and Bondholders (1998-2010)

<table>
<thead>
<tr>
<th>Case</th>
<th>Preemptive or Post-Default?</th>
<th>Default Date</th>
<th>Announcement of Restruct.</th>
<th>Start of Negotiations</th>
<th>Final Exchange Offer</th>
<th>Date of Exchange</th>
<th>Total Duration (Months)</th>
<th>Debt Exchanged in m US$</th>
<th>Cut in Face Value</th>
<th>Harcourt Estimate (Crucés/Trebesch)</th>
<th>Discount Rate (Crucés/Trebesch)</th>
<th>Outstanding Instruments Exchanged</th>
<th>New Instruments Exchanged</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pakistan (Bank Loans)</td>
<td>Post-Default</td>
<td>Aug-98</td>
<td>Aug-98</td>
<td>Mar-99</td>
<td>May-99</td>
<td>Jul-99</td>
<td>11</td>
<td>777</td>
<td>0.0%</td>
<td>11.6%</td>
<td>0.132</td>
<td>3 Eurobonds, 1 Loan</td>
<td>1 Loan</td>
</tr>
<tr>
<td>Pakistan (Ext. Bonds)</td>
<td>Preemptive</td>
<td>Aug-99</td>
<td>Sep-99</td>
<td>Nov-99</td>
<td>Dec-99</td>
<td>Apr-00</td>
<td>4</td>
<td>610</td>
<td>0.0%</td>
<td>15.0%</td>
<td>0.140</td>
<td>3 Eurobonds</td>
<td>1 Eurobond</td>
</tr>
<tr>
<td>Ukraine (Ext. Bonds)</td>
<td>Preemptive</td>
<td>Dec-99</td>
<td>Jan-00</td>
<td>Feb-00</td>
<td>Apr-00</td>
<td>Apr-00</td>
<td>4</td>
<td>1,598</td>
<td>0.9%</td>
<td>18.0%</td>
<td>0.163</td>
<td>4 Brady Bonds, 2 Eurobonds</td>
<td>1 Eurobond</td>
</tr>
<tr>
<td>Ecuador (Ext. Bonds)</td>
<td>Post-Default</td>
<td>Aug-99</td>
<td>Jul-99</td>
<td>Sep-99</td>
<td>Jul-00</td>
<td>Aug-00</td>
<td>25</td>
<td>6,700</td>
<td>33.3%</td>
<td>38.3%</td>
<td>0.173</td>
<td>4 Brady Bonds, 2 Eurobonds</td>
<td>2 Eurobonds</td>
</tr>
<tr>
<td>Russia (Bank Loans)</td>
<td>Post-Default</td>
<td>Dec-98</td>
<td>May-99</td>
<td>Feb-00</td>
<td>Aug-00</td>
<td>23</td>
<td>31,943</td>
<td>36.4%</td>
<td>50.8%</td>
<td>0.125</td>
<td></td>
<td>1 Eurobond</td>
<td></td>
</tr>
<tr>
<td>Moldova (Ext. Bonds)</td>
<td>Preemptive</td>
<td>Jun-02</td>
<td>Jun-02</td>
<td>Aug-02</td>
<td>Oct-02</td>
<td>2</td>
<td>40</td>
<td>0.0%</td>
<td>36.9%</td>
<td>0.193</td>
<td></td>
<td>1 Eurobond</td>
<td></td>
</tr>
<tr>
<td>Uruguay (Ext. Bonds)</td>
<td>Preemptive</td>
<td>Mar-03</td>
<td>Mar-03</td>
<td>Apr-03</td>
<td>May-03</td>
<td>2</td>
<td>3,127</td>
<td>0.0%</td>
<td>9.8%</td>
<td>0.090</td>
<td></td>
<td>18 Eurobonds</td>
<td>1 Eurobond</td>
</tr>
<tr>
<td>Serbia &amp; Monten. (Loans)</td>
<td>Post-Default</td>
<td>Dec-00</td>
<td>Sep-01</td>
<td>Jun-04</td>
<td>Jul-04</td>
<td>44</td>
<td>2,700</td>
<td>59.3%</td>
<td>70.9%</td>
<td>0.097</td>
<td></td>
<td>18 + 3 New Benchmark Bonds</td>
<td>1 Eurobond</td>
</tr>
<tr>
<td>Dominica (Bonds/Loans)</td>
<td>Post-Default</td>
<td>Jul-03</td>
<td>Jun-03</td>
<td>Dec-03</td>
<td>Apr-04</td>
<td>Sep-04</td>
<td>15</td>
<td>144</td>
<td>15.0%</td>
<td>54.0%</td>
<td>0.092</td>
<td>2 Bonds, short- and medium-term</td>
<td>3 Bonds</td>
</tr>
<tr>
<td>Argentina (Ext. Bonds)</td>
<td>Post-Default</td>
<td>Jan-02</td>
<td>Oct-01</td>
<td>Mar-03</td>
<td>Jan-05</td>
<td>Apr-05</td>
<td>42</td>
<td>60,572</td>
<td>29.4%</td>
<td>76.8%</td>
<td>0.104</td>
<td>66 US$ and ARS denominated Bonds</td>
<td>5 US$ and ARS denominated Bonds</td>
</tr>
<tr>
<td>Dom. Rep. (Ext. Bonds)</td>
<td>Preemptive</td>
<td>Apr-04</td>
<td>Jan-05</td>
<td>Apr-05</td>
<td>May-05</td>
<td>13</td>
<td>1,100</td>
<td>0.0%</td>
<td>4.7%</td>
<td>0.095</td>
<td></td>
<td>2 Bonds</td>
<td>2 Bonds</td>
</tr>
<tr>
<td>Dom. Rep. (Bank Loans)</td>
<td>Post-Default</td>
<td>Feb-05</td>
<td>Apr-04</td>
<td>Aug-04</td>
<td>Jun-05</td>
<td>18</td>
<td>180</td>
<td>0.0%</td>
<td>11.3%</td>
<td>0.097</td>
<td></td>
<td>Bank Loans, Arrears</td>
<td>1 Loan</td>
</tr>
<tr>
<td>Grenada (Bonds/Loans)</td>
<td>Preemptive</td>
<td>Oct-04</td>
<td>Dec-04</td>
<td>Sep-05</td>
<td>Nov-05</td>
<td>13</td>
<td>210</td>
<td>0.0%</td>
<td>33.9%</td>
<td>0.097</td>
<td></td>
<td>5 Ext. Bonds, 8 Bonds, 2 Ext. Loans, 1 US$ Bond, 1 EGS Bond, Mostly Cash, 1 US$ Bond, 1 Loan</td>
<td>1 Bond</td>
</tr>
<tr>
<td>Iraq (Bank/Comm. Loans)</td>
<td>Post-Default</td>
<td>in 2004</td>
<td>Jul-05</td>
<td>Jul-05</td>
<td>Jan-06</td>
<td>20</td>
<td>17,710</td>
<td>81.5%</td>
<td>89.4%</td>
<td>0.123</td>
<td></td>
<td>2 Bonds, short and medium-term</td>
<td>3 Bonds</td>
</tr>
<tr>
<td>Belize (Bonds/Loans)</td>
<td>Preemptive</td>
<td>Aug-06</td>
<td>Aug-06</td>
<td>Dec-06</td>
<td>Feb-07</td>
<td>6</td>
<td>516</td>
<td>0.0%</td>
<td>23.7%</td>
<td>0.096</td>
<td></td>
<td>7 Bonds, 8 Loans</td>
<td>1 Bond</td>
</tr>
<tr>
<td>Ecuador (Bond buy-back)</td>
<td>Post-Default</td>
<td>Dec-08</td>
<td>Jan-09</td>
<td>Apr-09</td>
<td>Jun/Nov-09</td>
<td>12</td>
<td>3,190</td>
<td>68.6%</td>
<td>67.7%</td>
<td>0.130</td>
<td></td>
<td>None (cash settlement)</td>
<td></td>
</tr>
<tr>
<td>Seychelles (Ext. Bonds)</td>
<td>Post-Default</td>
<td>Jul-08</td>
<td>Mar-09</td>
<td>Mar-09</td>
<td>Dec-09</td>
<td>19</td>
<td>320</td>
<td>50.0%</td>
<td>56.2%</td>
<td>0.107</td>
<td></td>
<td>1 Ext. Bond, 3 Ext. Loans, Notes</td>
<td>1 Bond</td>
</tr>
<tr>
<td>Cote D’Ivoire (Ext. Bonds)</td>
<td>Post-Default</td>
<td>Mar-00</td>
<td>Aug-09</td>
<td>Aug-08</td>
<td>Mar-10</td>
<td>Apr-10</td>
<td>21</td>
<td>2,940</td>
<td>20.0%</td>
<td>55.2%</td>
<td>0.099</td>
<td>2 Brady Bonds, Arrears</td>
<td>1 Bond</td>
</tr>
</tbody>
</table>