SOVEREIGN DEBT

# Sovereign Bond Contract Reform: Implementing the New ICMA Pari Passu and Collective Action Clauses

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The International Capital Market Association (ICMA) has recently published proposed standard terms for new, aggregated collective action clauses (CACs). Concurrently, ICMA released new model wording for the *pari passu* clause typically included in international sovereign bond contracts. These new CACs will make it much harder for holdout creditors to disrupt future bond restructurings or to be paid in full after the other bondholders receive haircuts.

Under the new contractual form, a supermajority of bondholders can vote to force non-participating creditors into a restructuring, subject to strong protections against the abuse of minority creditors by the majority. At the same time, the new *pari passu* clause is designed to prevent the kind of rulings that lead to a disruption in payments to investors, as was the recent case with Argentina. Neutralizing holdout creditors in this fashion is of immense economic importance. It should facilitate more predictable outcomes for debtors and creditors, and fairer outcomes among creditors in situations that require debt restructuring. These announcements and the commencement of issuance of bonds with these clauses are an important turning point in the evolution of sovereign bond markets.

This paper discusses the ICMA consultative process to develop the new clauses, explains the workings of CACs and the history of their adoption, analyzes the effect of the new clauses in reducing holdout activity and discusses the use of bondholder meetings and exchange offers to accelerate the conversion of outstanding debt stocks into the new format.

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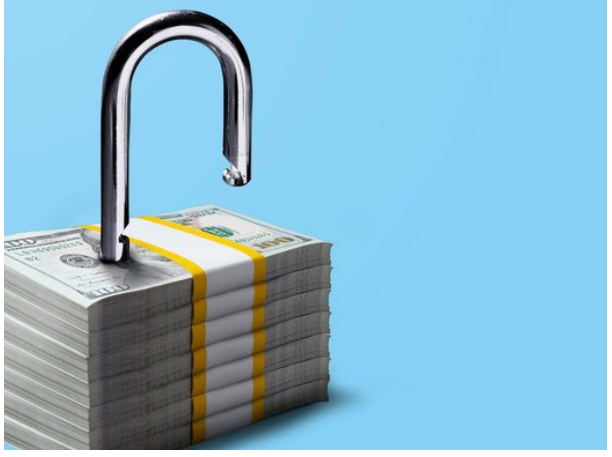

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