

MEMO# 25386

August 5, 2011

Consultation on Collective Action Clauses for Euro Zone Sovereign Debt

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TO: INTERNATIONAL COMMITTEE No. 18-11

FIXED-INCOME ADVISORY COMMITTEE No. 59-11 RE: CONSULTATION ON COLLECTIVE ACTION CLAUSES FOR EURO ZONE SOVEREIGN DEBT

At a summit held in March 2011, the European Council reaffirmed that all euro zone sovereign debt issued after July 2013 will include a standardized collective action clause (“CAC”) and directed that arrangements for including the clauses be decided following consultation with market participants and other stakeholders. In late July 2011, the Economic and Financial Committee’s Subcommittee on EU Sovereign Debt Markets (“Sub-Committee”) circulated an invitation to participate in a consultation regarding the standardized CAC. [\[1\]](#) The standardized CAC is based on those commonly used in the United States and the United Kingdom. The invitation included an explanatory note with a draft standardized CAC (“Explanatory Note”). [\[2\]](#) This policy measure is one of several intended to safeguard the financial stability of the euro zone.

The standardized CAC will be required for all new bonds, notes and other debt securities with an original stated maturity of more than one year issued by a national euro area government from July 2013, regardless of whether the debt is listed on an exchange, is actively traded or privately placed. Euro zone governments will be permitted to reopen existing securities issuances after July 2013 as necessary to ensure adequate liquidity, but the Sub-Committee expects this will only occur in limited cases. The standardized CAC will not be required for bonds issued by regional and local euro area governments, for actively traded syndicated loans contracted by covered borrowers or for bonds guaranteed by covered guarantors. [\[3\]](#) Nevertheless, a euro zone government not otherwise required to include the CAC may voluntarily include it.

Key Provisions

The Explanatory Note provides details regarding certain provisions, including: modification and approval thresholds; quorums; disenfranchisement; reserved matters; bondholder meetings; and governing law. Other matters also are addressed such as the treatment of zero-coupon and index linked obligations and the appointment of a calculation agent.

On modifications, the standardized CAC distinguishes between a reserved matter modification, meaning the modification of a bond's most important terms which will require the highest level of bondholder consent, and non-reserved matter modifications, meaning those modifications of less important terms which will require a lower threshold of bondholder consent. The Explanatory Note also addresses how the approval thresholds will be applied in the context of single series and cross series modifications, meaning modifications of a single bond series as distinguished from those involving more than one series of bonds. [4] The following sets forth the approval thresholds in the draft standardized CAC:

Reserved Matter	Non-Reserved Matter	Single Series Approval Threshold	Affirmative vote of not less than 66 2/3% of the aggregate principal amount of the outstanding bonds represented at a duly called meeting by written resolution if signed by holders of not less than 66 2/3% of the aggregate principal amount of the aggregate outstanding principal amount of outstanding bonds. Affirmative vote of more than 50% of the aggregate principal amount of outstanding bonds represented at a duly called meeting of bondholders or a written resolution signed by or on behalf of more than 50% of the aggregate principal amount of the outstanding bonds.
		Cross Series Approval Threshold	Voting: (a) Affirmative vote of not less than 66 2/3% of the aggregate principal amount of the outstanding debt represented at separate duly called meetings of the holders of all series (in the aggregate) affected by the modification; and (b) the affirmative vote of more than 50% of the aggregate principal amount of outstanding debt represented at separate duly called meetings of the holders of each series (taken individually) that would be affected by the modification.

Written resolution: (a) written resolution signed by or on behalf of not less than 66 2/3% of the aggregate principal amount of the outstanding debt of all series (in the aggregate) affected by the modification; and (b) a written resolution signed by or on behalf of holder of more than 50% of the aggregate principal amount of outstanding debt of each series (taken individually) that would be affected by the modification.

Same as above

The Explanatory Note indicates that the Sub-Committee considered allowing the approval of cross series modifications on an aggregate all-series basis only but rejected it as appearing unfair to allow a series of bonds to be modified over the objection of a majority of the affected holders as well as legal concerns that a single aggregate approval threshold may not be enforceable throughout the euro area. [5] The separate approval process for each affected series is also intended to avoid conflicts between laws that may govern the bonds of different series. All modifications will require the issuer's consent and may require the consent of others, such as a paying agent.

A modification cannot be approved at a bondholders meeting unless a quorum is present. The quorum of any initial meeting called to consider a modification is 66 2/3% of all then outstanding bonds in the case of a reserved modification and 50% in the case of a non-reserved matter. For an adjourned meeting, the quorum is 25% of the outstanding bonds irrespective of the type of modification. [6] The Sub-Committee stated it was aware of concerns that the high quorum would not prevent a reserved matter from being approved by a relatively small percentage of affected holders, especially at an adjourned meeting.

Nevertheless the Sub-Committee felt the concerns were misplaced and referred to evidence suggesting a significant percentage of the principal amount of outstanding bonds will in fact be represented at a meeting. Also, to the extent there is not a quorum at the initial meeting regarding a reserved matter modification, the Sub-Committee felt that such a circumstance would indicate an indifference of the absent holders and therefore be understood as a silent acquiescence to the proposed modification.

Consistent with market practice, the standardized CAC disenfranchises bonds held by the issuer or any of its ministries, departments or agencies. Such holdings therefore are treated as not outstanding for determining approvals or quorums. When government controlled entities hold bonds, those bonds will not be disenfranchised where the entity has autonomy of decision and is required by law to act independently of the issuer. The explanatory note describes certain safe harbors that expressly exempt certain government related entities.

The standardized CAC includes a list of reserved matters that the Committee describes as broadly consistent with those matters identified as reserved in other CACs currently in the market. The Sub-Committee notes that the list is expressed in general terms due to the wide range of debt securities covered by the standardized CAC (e.g., bearer, registered, dematerialized, zero-coupon and interest bearing, redeemable and non-redeemable and domestic and international). Examples of reserved matters include a modification that results in the reduction of any amount payable on the bond which would cover reductions of principal, interest or any additional amounts that may be payable as well as any modifications that would change an issuer's obligation to make a payment.

The standardized CAC includes mandatory rules for bondholder meetings so that the CAC operates in the same manner with the same legal effect in all euro area Member States. On the governing law, the Sub-Committee considered having the CAC governed by the law of one Member State, including the CAC in a treaty that would bind all euro area Member States and a provision that would require disputes to be heard in an agreed international forum or a single Member State court. The Sub-Committee, however, concluded that those arrangements would not significantly enhance uniformity of application of the CAC throughout the euro area and that other means more consistent with market practice were workable. The Sub-Committee ultimately decided that the standardized CAC should provide that any bond issued by a euro area Member State will be "governed by the law that governs the bond more generally, and any dispute arising out of or relating to the CAC included in a bond issued by a euro area Member State will be resolved on the same basis and before the same courts as are all other disputes arising out of or in connection with any other provision of that bond." [7]

Comments can be submitted until September 5, 2011. The Institute intends to submit a comment letter. Interested members should contact Susan Olson (solson@ici.org; 202-326-5813) or Heather Traeger (htraeger@ici.org; 202-326-5920).

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[Attachment \(in .pdf format\)](#)

endnotes

[1] Generally, CACs are clauses in sovereign bonds that establish a process for the orderly resolution of sovereign debt crises. For example, these clauses may be drafted to enable a supermajority of bondholders to agree to a debt restructuring that binds all bondholders, including nonvoting bondholders as well as those who voted against the restructuring. CACs are designed to encourage investment in a sovereign debt market by providing creditors with greater certainty regarding any debt restructuring process.

[2] The invitation letter and Explanatory Note are attached to this memorandum.

[3] The Explanatory Note indicates that these governmental obligations will not be required to include the standardized CAC because they make up a relatively small percentage of euro zone debt.

[4] There are provisions addressing how to determine if approval by the requisite principal amount has been reached in the context of multiple currencies and zero coupon bonds. There also are provisions addressing the calculation of bonds deemed to be “outstanding” for purposes of the approval of a modification and whether a quorum is present at a holders meeting.

[5] The draft standardized CAC includes a partial cross series modification provision addressing circumstances where a cross series modification would have been approved as to a reserved matter if the modification had only involved the bonds and one or more of the series that would have been affected by the modification.

[6] If a quorum is not present within 30 minutes of the time appointed for a meeting, the meeting may be adjourned for not more than 42 days and not less than 14 days as determined by the meeting’s chair.

[7] Explanatory Note, pages 8-9.