

MEMO# 25489

September 15, 2011

ICI Submits Comment Letter on Collective Action Clauses for Euro Zone Sovereign Debt

[25489]

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TO: FIXED-INCOME ADVISORY COMMITTEE No. 68-11
INTERNATIONAL MEMBERS No. 41-11 RE: ICI SUBMITS COMMENT LETTER ON COLLECTIVE ACTION CLAUSES FOR EURO ZONE SOVEREIGN DEBT

On September 12, 2011, ICI filed a comment letter on a standardized collective action clause (“CAC”) for euro zone sovereign debt issued after July 2013. We submitted the comment letter in response to an invitation by the Economic and Financial Committee’s Subcommittee on EU Sovereign Debt Markets (the “Committee”) to participate in a consultation regarding the standardized CAC. [*] The Committee’s invitation included a draft standardized CAC (the “Draft CAC”). Our comment letter on the Draft CAC is attached, and is summarized below.

The comment letter generally supports the concept of including CACs in EU sovereign debt, but notes that a standardized CAC is only one component of the European Council’s broader efforts to address the financial crisis in the euro area. The letter emphasizes the importance to ICI members, as sovereign debt investors, of standardized CAC terms that are fair, transparent, and consistent with existing standards in the international capital markets.

The comment letter acknowledges that the Committee has incorporated in the Draft CAC many of the key provisions that are standard in CACs for international sovereign debt. The letter explains, however, that certain of these provisions, as drafted, may not adequately protect the interests of bondholders, and that other key provisions that are not included should be given further consideration. These points are discussed briefly below.

Majority Approval Thresholds and Quorum Requirements: The Draft CAC sets out thresholds for majority approval by bondholders, and for establishing a quorum to approve matters at a bondholders meeting. The comment letter expresses concern that the proposed approval thresholds, especially for reserved matters (more important matters that require a higher

approval threshold), are lower than those that are standard in the international sovereign debt markets and are not sufficiently protective of bondholders. The letter recommends a higher approval threshold. The comment letter also recommends that the approval and quorum requirements should be measured based on the aggregate principal amount of outstanding bonds, rather than the aggregate principal amount of the outstanding bonds represented at a duly called meeting. Otherwise, there is too great a risk that reserved matters may be approved at a meeting by a minority of bondholders.

Cross-Series Modification: The comment letter explains that the Draft CAC's provisions on cross-series modification, or aggregation, which specify how voting will take place when bonds are issued in multiple series, would benefit from greater clarity and detail.

Reserved Matters: The letter recommends that change of law be a reserved matter in all instances (*i.e.*, even when the bond is issued under the law of the sovereign issuer), as the law governing a bond is an important term to an investor and should be subject uniformly to a higher voting threshold.

Disenfranchisement and Related Issues: The comment letter raises several concerns about the disenfranchisement provision in the Draft CAC, which generally precludes a sovereign issuer or any of its ministries, departments, or agencies, from voting the bonds they hold. The letter explains that, because of the close inter-relationships among EU Member States, a Member State or its agencies, or an EU supranational agency or authority, may be motivated to take actions to protect the interests of a particular Member State whose bonds it holds. The letter recommends that the Committee consider expanding the disenfranchisement provision to encompass supranational EU agencies or authorities. It also recommends that the disenfranchisement clause be modified to not provide an exclusion from disenfranchisement for government-related entities with "autonomy of decision," as defined in the Draft CAC, because the proposed definition is broad and potentially subjective.

Bondholder Representation: The letter recommends that the Committee add a provision to the Draft CAC allowing for the appointment of a bondholder representative or similar entity.

Bondholder Meetings: The comment letter recommends that the Committee broaden the provision regarding the circumstances under which bondholders may convene a meeting to make it more consistent with bondholder meeting provisions that are standard in CACs in the international sovereign debt markets.

Acceleration and Withdrawal of Acceleration: The Draft CAC does not include clauses providing for acceleration (causing the bonds, upon an event of default, to be immediately due and payable) and withdrawal of acceleration. The comment letter recommends that these provisions, which provide an important enforcement mechanism to bondholders in the event of default, be added to the Draft CAC.

Governing Law: The Committee proposes that the standardized CAC would be governed by the law that governs the bond more generally. The comment letter acknowledges that there is no easy solution to this issue, but suggests that the Committee consider whether it may be possible to develop mechanisms that would facilitate consistent interpretations of the standardized CAC across jurisdictions.

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[Attachment](#)

endnotes

[*] See ICI Memorandum No. [25386](#), dated August 5, 2011.

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