RESTRUCTURING SOVEREIGN BONDS:
HOLDOUTS, HAIRCUTS AND THE EFFECTIVINESS OF CACS

Discussion by:

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Overview

- Paper studies the holdout problem by reviewing the experience of 23 external bond restructurings
    - Constructs a new and comprehensive database
- Makes an important contribution to the literature
    - There are a number of theoretical studies on debt restructurings
    - But relatively little empirical work to guide and inform modeling choices

Key results

- Restructurings typically have high participation (90 percent or higher)
- But large variation in holdouts across bonds in a same restructuring
- Size of haircuts helps predict holdouts
- CACs help reduce holdouts
    - Effect more limited for "classic CACs"
    - Aggregative CACs more powerful

The holdout problem

- Holdouts more likely to be successful when they are small:
  - Ideal situation for a holdout is one with high participation
  - Country prefers to repay holdout in full than litigate or risk undermining restructuring
- That helps explain result of high aggregate participation
  - If participation is low, country cannot afford to repay holdouts in full; Needs to continue negotiating
- CACs bind on holdout creditors
  - No matter how much they dislike the offer, the bond terms will be changed by application of CAC
  - Can no longer litigate for repayment under original terms

Successful holdouts need:

- Own a bond that does not have CACs
  - Fewer and fewer bonds do not have CACs
  - Still needs to worry about exit consents (amendments to non-repayment clauses that make holding out harder)
- Own a bond where CACs rejected
- Take a blocking stake on a small bond series
  - E.g. 25% in a "Classic CAC" bond with 75% voting threshold
  - "Aggregation CACs" will close this option
- This implies a bipolar outcome for bonds with CACs:
  - At least 1/4 or 1/3 of creditors holdout, or
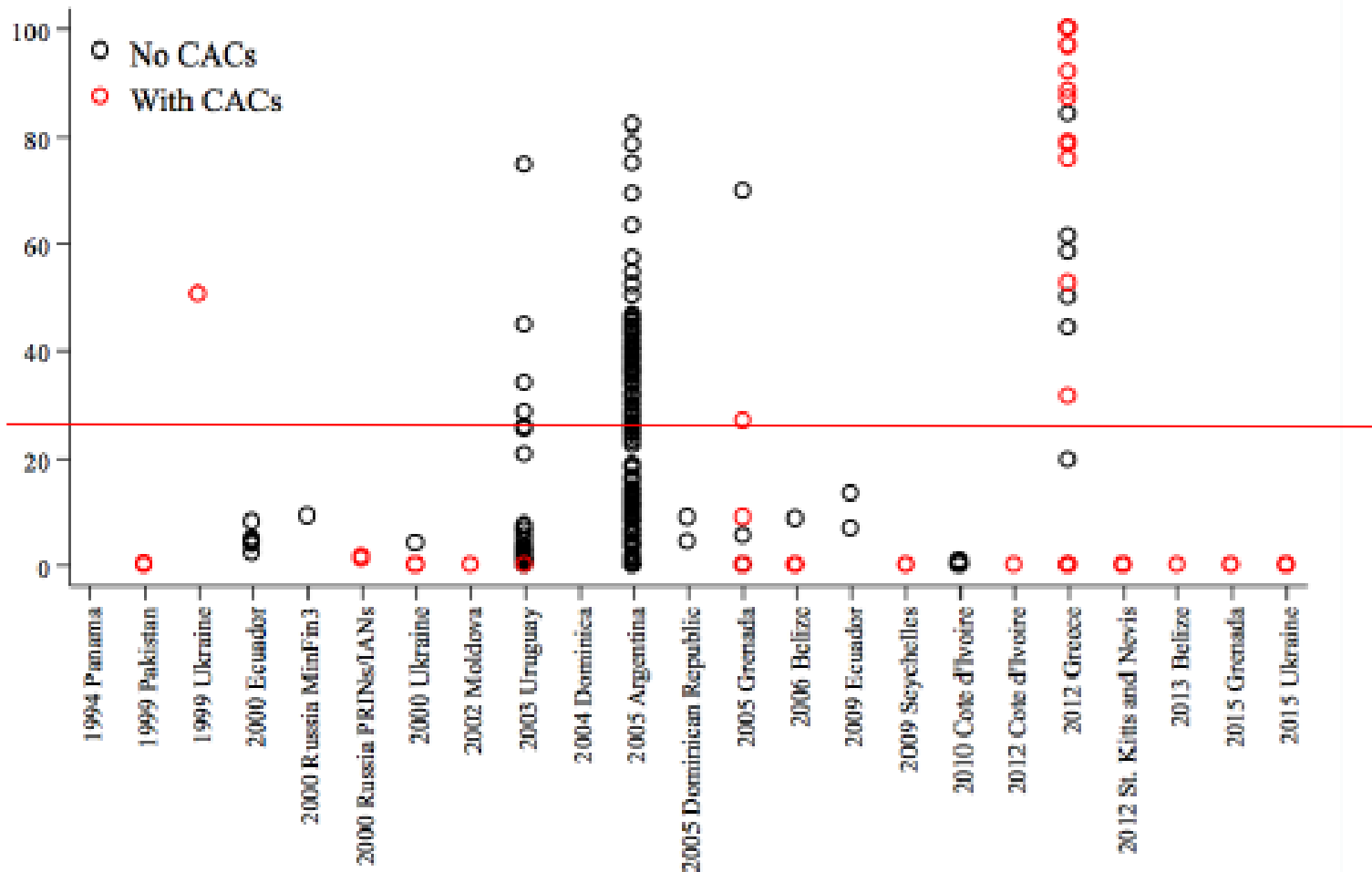 - No holdouts

Distribution of holdout rates

Figure 2: Distribution of Holdout Rates (in %)
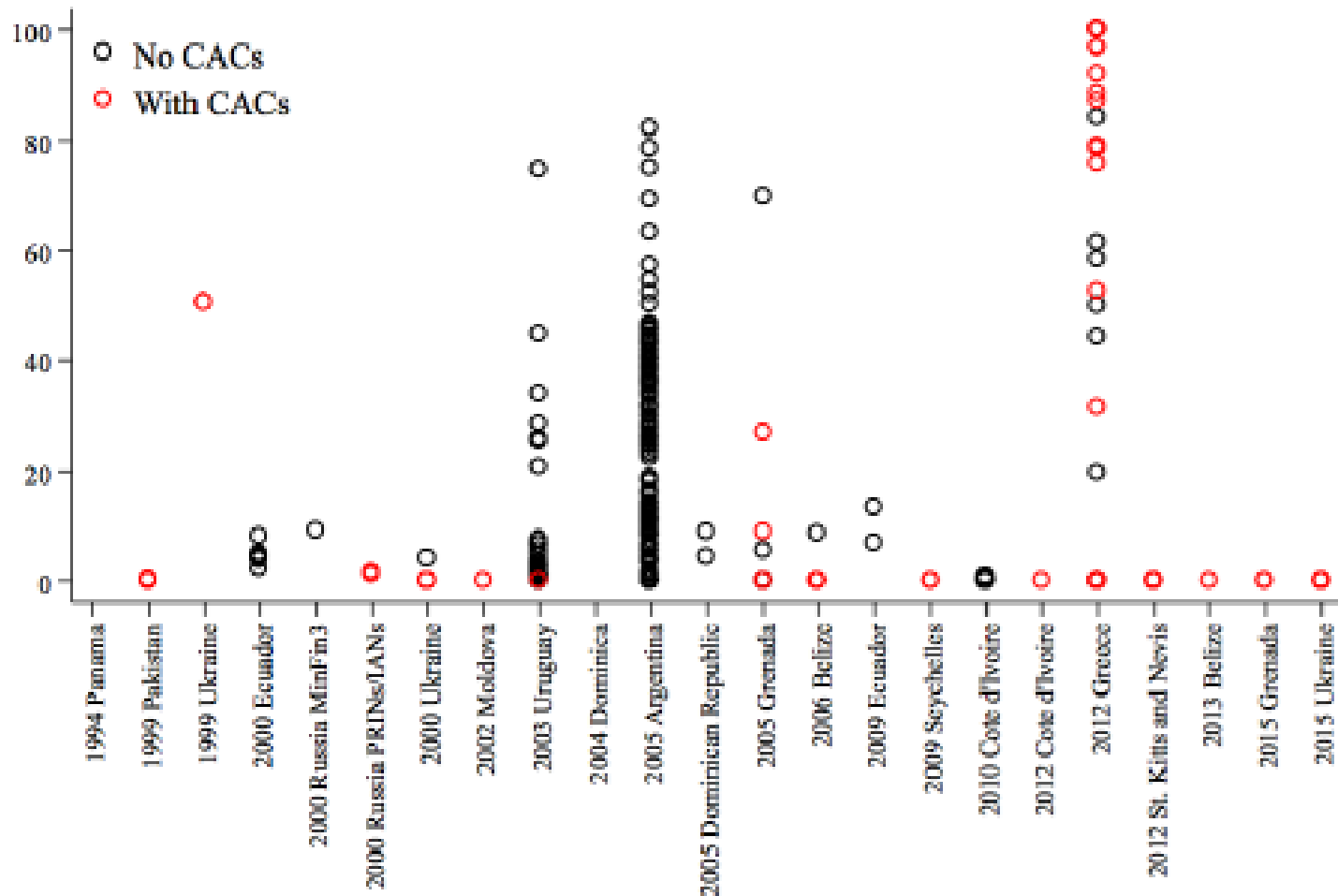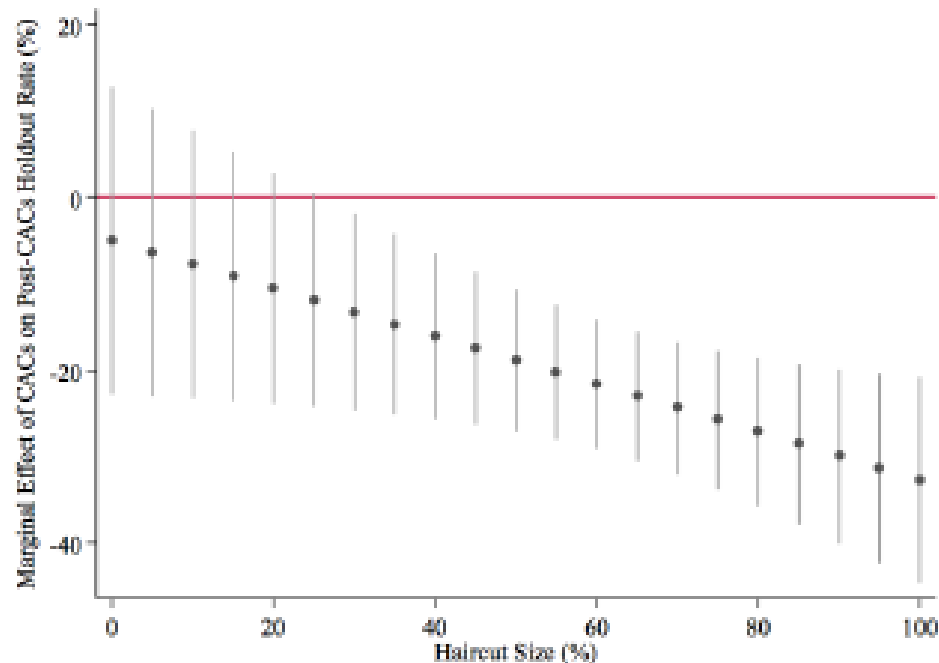
Distribution of holdout rates

Figure 2: Distribution of Holdout Rates (in %)

Comments: Test for corner solutions

- Specifications in the paper estimate holdout as a function of haircut, CACs, haircut*CAC interaction and other bond characteristics

Figure 5: Interaction: Marginal Effect of CACs Depending on Haircut Size

Comments: Test for corner solutions

- It would be interesting to econometrically test for corner solutions/bipolar outcomes
- One option could be to estimate a probit for whether or not the CACs are approved
- E.g. how haircuts, and other bond characteristics affect the probability of achieving critical mass of holdouts to block CAC
- Paper could elaborate on what is happening to the non-participating creditors after CACs
  - Do they end-up just exchanging the bonds like everyone else? Do they litigate? Can they?

Other comments: Measuring haircuts

- Paper uses an NPV based measure of haircut:

$$Haircut = 1 - \frac{Present\ Value\ of\ New\ Bond}{Present\ Value\ of\ Old\ Bond + Arrears}$$

- This definition makes sense in most applications

- But after a default, debt is accelerated and creditor has a claim for full face value of bond

- Market definition of haircut is based on value of new bond relative to face-value of old defaulted bond
  - It is a better measure of how much a creditor can potentially gain by holding out

Other comments: Measuring haircuts

- Market haircut tends to have less variation across bonds

- Empirical results are robust to using different metrics for haircuts. While NPV haircut has desirable features, the market based measure seems more relevant for holdout decisions and could be the baseline choice

- Could also have different implications for preemptive restructurings (before payments are missed and debt accelerated)

Other comments: Size of series

- The regressions control for the size of the bond issue
- But there may be strong non-linear effects
- Holdouts would prefer to focus on smaller series
- Could add dummies for smallest available series and/or dummies for relatively small (e.g. among the bottom decile or quartile of size)

THANK YOU