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RESCHEDULING AS THE GROUNDWORK FOR SECONDARY MARKETS IN SOVEREIGN DEBT

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§ 1 INTRODUCTION

The secondary market in the debt of less developed countries (LDC), now known as the "emerging markets', has been newsworthy throughout the 1990s because of its explosive growth[2] and the profitability of some investments in these markets.[3] However, few people appreciate how the strategy of repeated reschedulings in the 1980s laid the groundwork for the subsequent rapid development of this market. This little known role of reschedulings is the focus of this article.

The first response of international commercial banks to the debt crisis in 1982 was to reschedule the current debt of LDCs. Fresh loans were extended to permit the payment of interest upon the rescheduled debt.[4] This remained the standard response throughout the 1980s and received the imprimatur of the U.S. government in the Baker Plan.[5]

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1. Associate Professor of Law, Bond University. While all responsibility remains mine, I would like to thank Michael Chamberlin and Jonathon Murno of the Emerging Markets Traders Association for their helpful comments on an earlier draft.

2. The market existed in nascent form before the debt crisis but really started to grow after 1982. In 1983, market volume was, in the absence of accurate figures, approximately $500 -700 million face value debt. In 1984, total volume had risen to an estimated $2-2.5 billion. *In the Spotlight*, BANKNOTES 8 (providing an interview with Martin Schubert). By 1990, turnover had reached $100 billion; and by 1996, due to the conversion of most loans into Brady bonds, turnover was equivalent to $5,300 billion. *See* Brian O'Reilly, *Cooling Down the World Debt Bomb*, FORTUNE, May 20, 1991, at 123, 124; Voorhees, *Doses of Reality*, 40 LATIN FINANCE 19, 26 (1992); *cf. NMB Postbank - leading the field*, IFR REVIEW OF THE YEAR (supp. 1990) at 78, (stating an estimate of $75 billion). The 1996 figure is from Emerging Markets Traders Association, 1996 DEBT TRADING VOLUME SURVEY (March 17, 1997).

3. *Emerging Market Debts Extend Gains in U.S.*, REUTERS NEWS SERVICE, Nov. 4, 1996, *available in* LEXIS, World Library, Txtlne File.

4. While the scale of debt restructurings in the 1980s was unprecedented, sovereign debt restructurings themselves were not new. Between 1956 and 1974 eleven nations rescheduled a total of $7 billion of debt in thirty restructurings. From 1975 to 1981, fourteen nations rescheduled a further $10 billion of debt in twenty-five separate restructurings. *See* CHANDRA H. HARDY, RESCHEDULING DEVELOPING COUNTRY DEBTS, 1956-1981: LESSONS AND RECOMMENDATIONS 1-2 (1982); *see also* Peter H. Lindert, *Response to Debt Crisis: What is Different About the 1980s*, *in* THE INTERNATIONAL DEBT CRISIS IN HISTORICAL PERSPECTIVE 238 (Barry Eichengreen & Peter H. Lindert eds., 1989).

5. In October 1985, at the joint meeting of the International Monetary Fund and the World Bank in Seoul, South Korea, U.S. Treasury Secretary James Baker announced his "Program for Sustained Growth" for highly indebted nations. The program, dubbed the "Baker Plan," became the nucleus of the U.S. government debt policy for the next three

§ 2 A TYPICAL RESCHEDULING PACKAGE

A regular pattern for rescheduling[6] soon formed in 1983.[7] The first step in most reschedulings of commercial bank debt was to establish a steering committee to act as an advisory group and have a liaison with all bank creditors. The members of this committee were usually the major money-centre banks.[8] The steering committees required the debtor to complete, or enter into, a rescheduling of its official debts. The term "official debts" refers to debts to other governments[9] or international institutions such as the World Bank or International Monetary Fund [hereinafter IMF].[10]

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years. *See* Jeffrey Carmichael, *The Debt Crisis: Where Do We Stand After Seven Years?*,4 RESEARCH OBSERVER 121, 125 (July 1989). The plan proposed substantial new loans from commercial banks and official agencies tied to policy reforms in the debtor nations. The Baker Plan aimed to defeat the debt crisis through long-term growth in the debtor nations (as opposed to the short-term stabilization programs of the preceding three years). In Secretary Baker's words, "increased financing not only will ease current debt servicing difficulties, but will facilitate and support domestic policy changes to increase economic growth." Morris Goldman, *Confronting Third World Debt: The Baker and Bradley Plans*, 559 THE BACKGROUNDER 6 (January 22, 1987). However, neither the commercial banks nor the official agencies came close to lending the targeted amounts of fresh funds (Cline, *supra* p. 87-88). Perhaps, the most important aspect of the plan was the explicit acknowledgment by the governments of the developed world that a solution to the debt crisis required their involvement. RICHARD A. DEBS, DAVID L. ROBERTS & ELI M. REMOLONA, FINANCE FOR DEVELOPING COUNTRIES - ALTERNATIVE SOURCES OF FINANCE - DEBT SWAPS 13 (1987).

6. *See* Steven M. Cohen, *Give Me Equity or Give Me Debt: Avoiding a Latin American Debt Revolution*, 10:1 U. PA. J. INT'L BUS. L. 97 (1988) (stating that the regular pattern was modeled on the Mexican procedures).

7. The pattern formed quickly, as much out of the power of precedent (especially when everything was so rushed), as out of any careful analysis that the form of the reschedulings was the best possible; *see* Mark A. Walker & Lee C. Buchheit, *Legal Issues in the Restructuring of Commercial Bank Loans to Sovereign Borrowers*, *in* INTERNATIONAL BORROWING: NEGOTIATING AND STRUCTURING INTERNATIONAL DEBT TRANSACTIONS 459, 459-60 (D. Bradlow ed., 1986) [hereinafter INTERNATIONAL BORROWING].

8. A major tension in the rescheduling years was that the minor creditors became increasingly convinced over time that the steering committees, comprised as they were of banks heavily committed to the debtor nations, did not properly represent their interests and were in a position of conflict of interest. *See* Robert D. Sloan, *The Third World Debt Crisis: Where We Have Been and Where We Are Going*, WASH. Q., Winter 1988, at 103.

9. Including, for instance, debts to the trade finance authorities of such governments like the Export-Import Bank in the U.S. or the Export Credit Guarantee Department in the U.K. The rescheduling of official debts is handled through the "Paris Club" (which is named after its usual place of meeting and was first formed in 1956 for the consolidation and renegotiation of Argentina's trade debts and supplier credits). The Paris Club has no fixed membership, no office and no permanent administrative staff. Its members consist of the major creditors of the nation whose request for rescheduling is under consideration. Karen Hudes, *Co-ordination of Paris and London Club Reschedulings*, chap 17A *in* INTERNATIONAL BORROWING, at 451.

10. Trade finance and interbank credit lines were usually expressly maintained and not rescheduled. *See* Lee Buchheit, *Alternative Techniques in Sovereign Debt Restructur-*

The second step of most steering committees was to require the country to implement, or enter into, an economic program designed by the IMF.[11] The IMF conditioned its loans upon reformation of domestic economic policy in a process which became known as "structural adjustment."[12]

In addition to rescheduling official debts and adherence to the structural adjustment program, the other elements of a typical rescheduling included:

(a)new commercial bank loans, usually with a grace period on interest repayments of between two and four years;[13]

(b)new IMF loans for a three year period;[14] and

(c)the rescheduling of existing commercial bank loans over longer maturities and with substantial grace periods on capital repayments.[15]

From the beginning, loans were grouped for rescheduling based on their due dates. For instance, all $4.8 billion of Brazilian loans due in 1983 were rescheduled in one agreement.[16] From 1982 to 1984, debts falling due in the next year were generally rescheduled together.[17]

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ing, 2 U. ILL. L. REV. 371, 372-73 (1988).

11. Jeffrey Sachs, *Introduction*, *in* DEVELOPING COUNTRY DEBT AND THE WORLD ECONOMY 24 (J. Sachs ed., 1989). Soon after the crisis broke the IMF stepped into the role of economic overseer for debtor nations seeking a rescheduling. The commercial banks had firm views on the need for economic austerity by debtor countries but considerations of national sovereignty made direct commercial bank involvement in the economic policies of debtors a political impossibility. As an international institution, the IMF was able to play this supervisory role, but only at the cost of much resentment from within the debtor nations. Lee C. Buchheit, *Comity, Act of State, and the International Debt Crisis: Is There an Emerging Legal Equivalent of Bankruptcy Protection for Nations?*, 79 AM. SOC'Y OF INT'L. L. PROC. 126, 135 (1985).

12. "Structural adjustment" was a "stunningly bland name." *See* DUNCAN GREEN, SILENT REVOLUTION — THE RISE OF MARKET ECONOMICS IN LATIN AMERICA 11 (1995) (discussing policies with a stunningly high human cost). *See* WALDON F. BELLO, DARK VICTORY: THE UNITED STATES, STRUCTURAL ADJUSTMENT AND GLOBAL POVERTY (1994); Jerry Dohnal, *Structural Adjustment Programs: A Violation of Rights*, 1 AUST J. HUM. RIGHTS 57 (1994); SUSAN GEORGE, A FATE WORSE THAN DEBT (1988).

13. David Suratgar, *The International Financial System and the Management of the International Debt Crisis*, *in* INTERNATIONAL BORROWING — NEGOTIATING AND STRUCTURING INTERNATIONAL DEBT TRANSACTIONS, 459, 493,494 (Daniel D. Bradlow ed., 1986). Considerable pressure from the IMF and the central banks of the commercial banks' home countries often had to be brought to bear to persuade the commercial banks to "voluntarily" make these new loans.

14. *Id.* at 495 (indicating that the IMF funds were typically only a fraction of the new money extended by the commercial banks).

15. *Id.*

16. Robert Pastor, *The Debt Crisis: A Financial or a Development Problem*, *in* LATIN AMERICAN DEBT CRISIS: ADJUSTING TO THE PAST OR PLANNNING FOR THE FUTURE 12 (Robert Pastor ed., 1987).

17. *Id.* at 12, *see* tbl 1.3. Occasionally, in this period, debts falling due in the next two years were rescheduled together.

However, these annual reschedulings were burdensome and by 1984-1985 the trend was to negotiate multi-year rescheduling agreements.[18] Accordingly, all of Mexico's loans due from 1985 to 1990 were rescheduled in one agreement.[19]

New money to facilitate interest payments accompanied most of the reschedulings. The title "new money loans" is misleading since the money never reached the debtors but went directly to their accounts with the lending banks.[20] In reality, the new money was a method of capitalizing interest payments in advance.[21] It was usually less than the forthcoming interest payments and as a result the net transfer of resources was in favor of the banks.[22] Fresh capital to support economic development in the region was virtually non-existent in the 1980s.

In the early debt reschedulings, the banks demanded a substantial premium to compensate for the high risks of such lending. As a result, rescheduling increased the financial burden on the debtors. The average interest rate was the LIBOR[23] plus 2.2 percent[24] and generous fees averaged 1.2 percent of the loan.[25]

As the cycle of reschedulings continued, both the interest rates and fees were progressively reduced. By 1984 the average margin over LIBOR was 1.77 percent and average fees were 0.8 percent.[26] Later still, the Mexican rescheduling of 1987 set a new low standard for interest rates at 13/16 th over LIBOR.[27] Banks had finally learned that higher premiums created higher risks by increasing the burden on debtors.[28]

18. Implementation of multi-year restructurings began in 1984. *See* Lee Buchheit, *You'll Never Eat Lunch in This Conference Room Again*, 1988 INT'L FIN. L. REV. 11 (1988). (indicating that these restructurings had, then unrecognized, subsequently substantial benefits for the secondary market). *See also* UNITED NATIONS ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN AND UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS, TRANSNATIONAL BANK BEHAVIOR AND THE INTERNATIONAL DEBT CRISIS 15 (1989) [hereinafter ECLAC/CTC].

19. The amount rescheduled was $48.7 billion. *See* Pastor, *supra* note 16. *See also* Buchheit, *supra* note 11, at 132 (considering multi-year restructurings).

20. Sachs, *supra* note 11, at 26.

21. *See* ECLAC/CTC, *supra* note 18, at 114.

22. SACHS, *supra* note 11, at 10.

23. LIBOR is an acronym for the London Interbank Offered Rate and represents the cost of banks funding themselves in the London interbank market.

24. Pastor, *supra* note 16, at 11.

25. *Id.*

26. *Id.*

27. Sloan, *supra* note 8, at 109.

28. *See* Hossein Askari, Third World Debt and Financial Innovation: The Experience of Chile and New Mexico 21 (1991).

§ 3 THE OVERALL EFFECT OF THE RESCHEDULINGS

From the outset some believed that rescheduling was a placebo that would never solve the debt problem.[29] Most, however, believed that by buying time the debtor nations could trade their way out of their problems.[30] Time did significantly ameliorate the problem for the banks.[31] As the 1980s progressed, the borrowers kept servicing their debts and the banks kept booking the profits from these massive loans.[32] The banks accumulated reserves and increased their primary capital[33] so that by the end of the decade a default would not have threatened the solvency of most banks. Indeed, one could characterize the entire thrust of the debt restructurings of the 1980s as an attempt to prevent a massive shakeout in the international financial system. As a senior official in the General Accounting Office said in 1989, "we believe that the efforts up until recently — all the restructurings . . . were measures to get us from there to here without crashing the banking system."[34]

In contrast, time did nothing but worsen the economic plight of the borrowers.[35] As Carlos Marichal wrote in 1989:

Repayment of the debts has meant enormous sacrifices for the peoples of Latin America. At the urging of the bankers and the officials of

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29. Pastor, *supra* note 16, at 11.

30. *Id.* Many believed in late 1982 and 1983 that the crisis was one of short-term liquidity, not solvency. *See, e.g.*, CARLOS MARICHAL, A CENTURY O F DEBT CRISIS IN LATIN AMERICA 239 (1989) (indicating that rescheduling was an entirely appropriate response to the problem).

31. Sloan, *supra* note 8, at 103-11.

32. Indeed, with the exception of Bank America, the net income of the nine largest U.S. banks continued to rise throughout the period from 1982 to 1986, while the debt crisis was imperiling the very existence of many of these major banks it was also, ironically, enhancing their short-term profitability. *See* ECLAC/CTC, *supra* note 18, at 61.

33. The nine largest US commercial banks nearly doubled their capital from $29 billion in 1982 to $55.8 billion in 1988. The ratio of the Latin American exposure of these nine banks to their capital decreased from 176.5% to 83.6% over the same period. *See* Atsushi Masuda, *Mexico's Debt Reduction Agreement and the New Debt Strategy*, 11 EXIM. REV. 26, 36-37 (1991).

34. Testimony of Dr. Allen Mendelowitz, Director of the Trade, Energy and Finance Division of the General Accounting Office, before the International Banking Subcommittee, *Federal News Service* (June 27, 1989) p.9 of 32 pages of testimony.

35. In Latin America, real GDP per capita fell dramatically in the 1980s and the net capital flow was substantially in favor of the developed world. *See* Jesus Silva-Herzog, *The Costs for Latin America's Development*, *in* LATIN AMERICAN DEBT CRISIS, *supra* note 16, at 35; Harold James, *Deep Red: The International Debt Crisis and its Historical Precedents*, *in* AMERICAN SCHOLAR, Summer 1987, at 331, 340; *see also* Askari, *supra* note 28, at 19. On the effect of the rescheduling years on Latin America, *see* Carmichael, *supra* note 5 at 139; Rudiger Dornbusch, *in* DEVELOPING COUNTRY DEBT AND THE WORLD ECONOMY, *supra* note 11, at 310; Lindert, *supra* note 4, at 262-63; and Sloan, *supra* note 8, at 111. In sub-Saharan Africa, where most debt was to official lenders, the situation was even more dire: *See* Abbey, *Growing out of debt — the African problem*, *in* THIRD WORLD DEBT: MANAGING THE CONSEQUENCES (Stephany Griffith-Jones ed., 1989).

the International Monetary Fund, governments have imposed painful austerity programs on their citizens . . . to extract sufficient revenue for paying foreign debts. These programs have led to . . . a sharp deterioration in basic living standards. Despite these sacrifices, there has been a steady worsening of the economic situation in most countries . . . [and] record levels of unemployment intensify the misery and discontent.[36]

Neither did more time help matters. As Duncan Green wrote in 1995:

An investment collapse has left the region burdened with a crumbling infrastructure of potholed roads, electricity blackouts and water shortages which will take decades to make good.. . . In human terms, the failure has been far more profound . . . terrible damage [has been inflicted] on the poor. By 1993, 60 million more Latin Americans had been driven below the poverty line, bringing the total to nearly half of the population.[37]

The debt crisis has been, primarily, a financial problem in the West. In Latin America it has long been a political and social issue to provide sufficient food, adequate shelter and basic healthcare.[38]

§ 4 RESCHEDULING AND THE SECONDARY MARKET

However, while the direct effects of rescheduling and the accompanying structural adjustment programs on the debtor nations were adverse in the extreme, the indirect effects of rescheduling were more positive. The rescheduling process facilitated the growth of the secondary market for LDC debt and the secondary market in turn eased the burden on debtor nations. The market benefited the debtors by first permitting formal and informal debt buy-backs[39] which, when secondary market prices were as low as 20 percent of the face value, were a particularly good investment of foreign exchange for debtor nations.[40]

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36. *See* MARICHAL, *supra* note 30, at 237; *see also* Wade Mansell, *Legal Aspects of International Debt*, 18 J.L. AND SOC'Y 381 at 388-90 (1991). The burden of the rescheduling years has fallen mostly upon the very poorest people in the debtor nations.

37. Duncan Green, *Hidden Fist Hits the Buffers*, NEW INTERNATIONALIST, Oct. 1995, at 35; *see also* CARLOS CASTANEDA, UTOPIA UNARMED 5 (1993) (stating that "[d]uring the 1980s and through the beginning of the 1990s, the hemisphere suffered its worst economic and social crisis since the Depression. In 1980, 120 million Latin Americans, or 39 percent of the area's population, lived in poverty; by 1985 the number had grown to 160-170 million; toward the end of the decade it was estimated at the appalling figure of 240 million").

38. Political demonstrations in Latin America in the late 1980s and in Africa to this day are commonplace in protesting the harsh conditions imposed by servicing the foreign loans . *See* MARICHAL, *supra* note 30, at 237-239; Dohnal, *supra* note 12, at 68.

39. As their name implies, debt buy-backs involve the acquisition of the debt by or on behalf of the debtor either directly from the creditors or through the secondary market.

40. Buy-backs came in many forms in the 1980s, including official programs operated by the debtor governments in Brazil, Chile and elsewhere. Another important form was

Second, the market made necessary[41] and facilitated[42] the Brady Plan which brought with it an element of debt relief.

Growth of the Secondary Market

The rescheduling process supported the growth of the secondary market by: (1) replacing a multiplicity of debtors with one debtor; (2) consolidating the indebtedness in a handful of agreements; and (3) standardizing the transfer provisions in those agreements.

[1] The Replacement of Many Debtors With One

In most rescheduling agreements, and the accompanying new money agreements, the debtor was the sovereignty. Occasionally, the debtor would be the nation's central bank and the sovereign would be the guarantor. In either case, all the loans would thereafter trade at the one price based on the sovereign's credit. Without rescheduling, trading this debt in the secondary market would have required knowledge of the creditworthiness of hundreds of different borrowers. For instance, in Mexico alone there were over 50 borrowers before 1982, the

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the repurchase of private sector debt by Latin American corporations. For instance, between 1983 and 1988, Mexican corporations almost halved their level of indebtedness from $22.3 billion to $14.5 billion principally through buy-backs. In Brazil, these private buy-backs were often initiated by a foreign investor who would enter into an agreement with a local company that the company would redeem its foreign debt in local currency when the debt was acquired and tendered to it by the foreign investor. It has been estimated that $3 billion of Brazilian debt was discharged in this manner in 1988. *See*, Comments of Rudiger Dornbusch on the article by Bulow and Rogoff, *The Buyback Boondoggle*, 1988 2 BROOKINGS PAPERS ON ECONOMIC ACTIVITY 675 at 699. With hindsight, debt buy-backs proved to be the principal source of debt relief for Latin American debtors in the 1980s and the most effective method of debt reduction available. For a more detailed analysis of the role of buy-backs, see Buckley, *Debt Exchanges Revisited — Lessons from Latin America for Eastern Europe*, NW. J. INT'L L. & REV. (forthcoming May 1998).

41. The market made the Brady Plan necessary by enabling some regional U.S. and continental European banks to dispose of their LDC debt portfolios in the late 1980s. These banks were able to do this because their exposures were usually relatively small, their loan loss provisions relatively large, and their capital relatively healthy. This led to a breakdown in creditor solidarity as these banks began to refuse to participate in the extensions of new money which accompanied each restructuring under the Baker Plan. This unraveling of the Baker Plan made necessary a new approach.

42. The secondary market in loans facilitated the Brady Plan in four ways: (i) the market provided the prototype (as the relevant parties could see the loans trading like bonds each day, it was a small step to conceive of their securitisation into bonds); (ii) the market provided a secondary market for the bonds; (iii) the market established there was investor appetite for such securities; (iv) the market discounts afforded a strong argument for debt relief. The combined effect of these four factors was so significant that without the secondary market the Brady Plan may have been too large a step into the unknown to attract the support of the U.S. Treasury and, without the support of, and strong persuasion of bankers by, the U.S. Treasury, the Brady Plan would not have come to pass.

great majority consisting of private sector corporations.[43] The range of prices, the need to know the credit of each separate borrower, and the lack of fungibility between separate loans made to borrowers in the one country would each have complicated and reduced the volume of trading in this market.

Another effect of rescheduling had significant advantages for the architects of the process. The leader banks,[44] as the dominant members of the steering committees for the reschedulings, devised and directed this rescheduling process and thereby obtained advantages which are not widely appreciated. The leader banks had generally been the most adventurous group of lenders in the 1970s and had "tended to depend on income from *special* deals with riskier clients willing to pay higher fees, commissions and interest to gain market access."[45] These "riskier clients" were usually private sector borrowers of marginal creditworthiness. In the reschedulings the leader banks often improved their security after the fact by converting their private sector loans into rescheduled sovereign loans.[46] The challenger and follower banks had a higher proportion of their exposure to more creditworthy debtors such as the sovereigns and major parastatals and, thus, benefited much less than the leaders from this rescheduling process.[47]

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43. UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS, DEBT EQUITY CONVERSIONS – A GUIDE FOR DECISION MAKERS 18 (1990). Admittedly, the borrowers of the largest amounts by far were the sovereign and parastatals, like Pemex.

44. The United Nations Economic Commission for Latin America and the Carribbean & United Nations Centre on Transnational Corporations identified three groups of lenders, leaders, challengers and followers, as follows: (i) The "leader" banks were all United States banks and essentially dominated syndicated lending in the 1970's (Chase Manhattan, BankAmerica, J.P. Morgan and Manufacturers Hanover); (ii) the "challenger" banks were from North America, Europe and Japan and competed aggressively with the leaders for the lending busines (Lloyds, Bank of Montreal, Bank of Tokyo, Bankers Trust, Chemical, Canadian Imperial Bank of Commerce, Toronto Dominion, Commerzbank Bank of Nova Scotia and Long Term Credit Bank of Japan); (iii) the "follower" banks were all non-U.S. and had a strong interest in lending to the region without being as aggressive as the leaders and challengers (National Westminster, Deutsche Bank, Barclays, Dresdner, West Deutsche LB, Royal Bank of Canada, Midland Bank, Credit Lyonnais, Industrial Bank of Japan and Banque Nationale de Paris) ECLAC/CTC, *supra* note 18.

45. *Id.* at 12.

46. *Id.* at 14-15 & 59-61. In the words of the U.N. study, at 61, "it seems that the leaders used their domination of the bank steering committees to gain particular advantage in terms of greater security for their more risky exposure and an improved income stream from fees and punitive interest rates".

47. The standard theoretical reason given by the leader banks for requiring the sovereign guarantee of all outstanding foreign indebtedness, both private and public, was that upon the onset of the debt crisis most debtor governments took control of all foreign exchange in their economy by requiring private sector entities to sell their foreign exchange to the Central Bank. If the government wished to centralize control of foreign exchange, the creditors argued, then the government must also assume responsibility for the repayment of all indebtedness incurred in that nation. The practical reason given by the leader banks was less subtle — if the government wanted the creditor's cooperation

[2] The Consolidation of Indebtedness in Fewer Agreements

Without rescheduling, the mechanics of secondary market trading would have been difficult. The transferability of the loans was the product of contract— each loan agreement had a provision which regulated whether and how the obligation was transferable. Before rescheduling, the indebtedness of the 1970s was recorded in thousands of lengthy loan agreements and trading the debt would have required access to, and knowledge of, these agreements. The research required for each transfer would have substantially slowed trading and substantially increased the related legal costs. These difficulties were highlighted in 1993-94 when Russian debt began to be actively traded in the secondary market.[48] The Russian loans had not been rescheduled and their trading posed many problems. In the words of a trader, "These loans were never meant to be traded.. . . There is [not] the . . . degree of commonality between all the loans that you found with Latin American debt."[49] That degree of commonality was a direct product of the rescheduling process.

The adoption of multi-year rescheduling agreements and compendious new money agreements for Latin American debt in the rescheduling years dramatically reduced the number of agreements which evidenced and governed the debt. For most nations, by 1988 the majority of their debt which was tradable in this market was to be found in a handful of rescheduling agreements and two or three new money agreements.[50] For instance, in Mexico by 1988, the multiplicity of loan agreements with over 50 borrowers had been reduced to a handful of restructuring agreements and a similar number of new money agreements[51] with Mexico the borrower or guarantor in each. Accordingly, traders and their legal advisers had to understand only a relatively small number of agreements to be equipped to trade all of Mexico's outstanding loans.[52]

[3] The Standardization of the Transfer Provisions

Of all the standard clauses contained in sovereign loan agreements, the secondary market was principally concerned with the proper identi-

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on the rescheduling of public sector debts, then it must cooperate by assuming its private sector's exposure. *See* LEE C. BUCHHEIT, THE ROLE OF THE LAWYER IN EXTERNAL DEBT MANAGEMENT 8 (1995).

48. *Russia: trading needs simplified*, 1017 IFR 42, Feb 12, 1994. Russian debt has since been securitised in a Brady-style rescheduling.

49. *Id.*

50. *See* Pastor, *supra* note 16, see table 1.3 at 12.

51. *Id.*

52. *Id.* (indicating that each of these agreements had essentially identical transfer provisions).

fication of the tranche of debt being sold, the interest rate and the transfer/assignment clause. Reschedulings meant that the transfer/assignment clauses became relatively quickly standardized for most of a country's indebtedness. Furthermore, certain clauses were adopted in the restructuring agreements of more than one country and this further standardized matters.[53] The explanation for this trend is simple.[54] The community of lawyers actively engaged in sovereign debt restructurings was quite small.[55] It was common for one firm to act in a number of reschedulings, often simultaneously.[56] Naturally, the documents from the previous transaction were used as precedents for the latest rescheduling and the transfer/assignment clause was rarely the subject of much negotiation. The form offered up by the lawyers for the creditors would often survive untouched in the final agreement.[57]

The standardization of the transfer provisions greatly facilitated the secondary market's trading of these loans. After lawyers had drafted a standard assignment agreement, the documentation of day-to-day transactions could be handled by supervised paralegals and thus legal costs were greatly reduced. Without widespread debt rescheduling, the number of loan agreements with various transfer provisions would have required an attorney's input for each assignment.[58]

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53. For instance, the transfer provision was in substance identical in each of (i) the $3,700,000,000 1985 Term Credit Agreement dated as of August 1, 1985 among the Banco Central de la Republica Argentina as Borrower, the Republic of Argentina as Guarantor, Citibank NA as Agent, and others; and (ii) the New Restructure Agreement dated as of August 29, 1985, among the United Mexican States as Obligor, Banco de Mexico as the Central Bank of the United Mexican States, and others. Furthermore, the same provision saw service again, this time with a simple addendum as to participation under the Increased Costs Clause in both (a) the Restructuring Agreement dated as of December 16, 1986 among the Republic of Chile as Obligor, Compagnie Luxembourgeoise AG — Dresdner Bank International as Servicing Bank and others; and (b) the $925,000,000 Credit Agreement dated as of May 20, 1985 among the Central Bank of the Philippines as Borrower, the Republic of the Philippines as Guarantor, Manufacturers Hanover Trust Company as Agent and others.

54. As stressed by those closely involved in the process, "it would be incorrect to suppose that any trend toward an increasing standardization of the documentation for sovereign debt restructuring results entirely from a considered and rational judgment.... There [is] a more human explanation for this phenomena": Walker & Buchheit, *supra* note 7, at 459-60. The explanation is the power of precedents. *Id.*

55. *Id.*

56. *Id.* at 460 (stating that the one firm, however, would usually only act for either creditors or debtors in each of the restructurings in which it was involved).

57. *See* Peider Konz, *The Third World Debt Crisis*, 12 HASTINGS INT'L & COMP. L. REV. 527 at 532 (1989) (stating that "concrete experience has shown ... that sovereign borrowers have often given too little autonomous thought to some of the key provisions of loan or loan restructuring agreements").

58. The standardization of transfer procedures and documentation was further assisted by the work of the Emerging Markets Traders Association which produced standard form trade confirmations for many classes of asset (*see Emerging Markets Association 1994 Annual Report* at 9), a standard loan assignment (*see* Standard Terms for

§ 5 CONCLUSION

Rescheduling replaced the numerous debtors in less developed country with a single debtor.[59] It replaced the hundreds of loan agreements which evidenced the foreign indebtedness of most nations with typically less than ten. Often it replaced the wide variety of transfer provisions in those loan agreements with only one or two provisions. In short, the rescheduling process created a legal environment in which the debts of one country were almost fungible, i.e. the terms governing all of one nation's indebtedness were so similar that most creditors were indifferent as to which particular agreement governed the indebtedness they were to sell or buy.[60] The necessary groundwork had been laid for an efficient secondary market.[61]

Assignment of Loan Assets, April 15, 1996 (copy on file with the author) and *Emerging Markets Traders Association 1995 Annual Report* at 11), and a netting facility (*see Emerging Markets Traders Association 1994 Annual Report* at 9). Over time, the netting facility matured in 1995 into Match-EM, an instantaneous matching system for the confirmation and settlement of trades (*see Emerging Markets Traders Association 1996 Annual Report* at 5) and ultimately, in 1997, into the Emerging Markets Clearing Corporation (*see Emerging Markets Trading Association 1996 Annual Report* at 9-10).

59. Or two, if one is technical and distinguishes cases in which the sovereign is debtor from those in which the central bank is debtor and the sovereign is guarantor — the secondary market made no such distinction.

60. An exception was when, under some debt-equity schemes, only certain indebtedness was eligible for conversion into equity.

61. Whether the market was efficient in an economic sense is a separate issue; *see* generally Suk Hun Lee et. al., *The Behavior of Secondary Market Prices of LDC Syndicated Loans*, 20 J. BANKING & FINANCE 537 (1996).