

September 12, 2011

Via email (ECFIN-Consultations@ec.europa.eu)

Mr. Philippe Mills

Chairman

Economic and Financial Committee

Sub-Committee on EU Sovereign Debt Markets

Re: Response to Consultation of Market Participants and Other Stakeholders on Collective Action Clauses to be Included in Euro Area Sovereign Securities

Dear Mr. Mills:

The Investment Company Institute (“ICI”) is pleased to have the opportunity to comment on the draft collective action clause (“Draft CAC”) produced by the Economic and Financial Committee’s Sub-Committee on EU Sovereign Debt Markets (the “Committee”).¹ ICI is the national association of U.S. registered investment companies, including mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts. ICI encourages adherence to high ethical standards, promotes public understanding, and otherwise advances the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$12.9 trillion and serve over 90 million shareholders. Our members invest in a variety of debt securities issued by EU Member States, and therefore have an interest in seeking to ensure that the terms of a standardized CAC for EU sovereign debt (“standardized CAC”) are fair, transparent, and consistent with existing standards in the international capital markets.

We understand that development of a standardized CAC is one component of the European Council’s broader efforts to address the financial crisis in the euro area.² We generally support the concept of including CACs in EU sovereign debt, as CACs may offer advantages to both sovereign issuers and investors in sovereign debt.³ CACs may benefit sovereign issuers, both at the time they issue

¹ The EFC Sub-Committee on EU Sovereign Debt Markets Collective Action Clause Explanatory Note (“Explanatory Note”) and Draft CAC were sent via cover of Invitation to Participate in the Consultation of Market Participants and Other Stakeholders on Collective Action Clauses to be Included in Euro Area Sovereign Securities (July 23, 2011).

² See Statement by the Eurogroup, *available at* http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/118050.pdf

³ See, e.g., Report of the G-10 Working Group on Contractual Clauses (September 26, 2002), *available at* <http://www.bis.org/publ/gten08.pdf> (“G-10 Report”).

debt by allowing an issuer to secure more favorable debt terms and, if the issuer later encounters financial distress, by facilitating the restructuring process. Bondholders may benefit from CACs because CACs allow a supermajority of investors to agree on a restructuring that is binding on all investors, facilitate communications among bondholders, and prevent a small minority of investors from preventing a restructuring that is acceptable to the other investors. CACs also provide predictability for both issuers and investors in the event a restructuring is necessary and can prevent more drastic action by a sovereign issuer in financial distress. CACs generally are understood to result in a more efficient restructuring process.

We appreciate that the Committee has incorporated in the Draft CAC many of the key provisions that are standard in CACs for international sovereign debt and provide important bondholder protections.⁴ We have concerns, 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. Our concerns are detailed below.

Majority Approval Thresholds and Quorum Requirements

To approve reserved matters, as defined in the Draft CAC, the Draft CAC requires an affirmative vote of not less than 66 2/3% of the aggregate principal amount of the outstanding bonds represented at a duly called meeting (or more than 50% for non-reserved matters).⁵ A modification cannot be approved at a bondholders meeting unless a quorum is present. The Draft CAC defines a quorum for a reserved matter to be 66 2/3% of the aggregate principal amount of the bonds then outstanding (and not less than 50% for non-reserved matters).⁶ If the meeting is adjourned, the quorum is not less than 25% of the aggregate principal amount of the outstanding bonds, irrespective of the type of modification.⁷

We are concerned that these approval thresholds, especially for reserved matters, are lower than those that are standard in the international sovereign debt markets and are not sufficiently protective of

⁴ See, e.g., ICMA Handbook Section 7, Part VIII, Standard Collective Action Clauses (CACs) for the Terms and Conditions of Sovereign Notes (October 2004) ("ICMA Standard CAC"); G-10 Report, *supra* note 3.

⁵ Draft CAC Clauses 2.1 and 2.5. The thresholds for approval by written resolution are 66 2/3% of the aggregate principal amount of outstanding bonds for reserved matters, and more than 50% for non-reserved matters.

⁶ Draft CAC Clause 4.5.

⁷ Draft CAC Clause 4.6. The Draft CAC provides that 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.

bondholders. We believe that a threshold of 75% for reserved matters, for example, would be more appropriate and would better balance the interests of issuers and investors.⁸

We also believe that the approval and quorum requirements should be measured based on the aggregate principal amount of outstanding bonds, regardless of whether approval occurs at a meeting or by written resolution.⁹ Otherwise, there is too great a risk that reserved matters may be approved at a meeting by a minority of bondholders.¹⁰ The Explanatory Note acknowledges these concerns, but states that the Committee believes they are misplaced because a significant percentage of bondholders is likely to be represented at a meeting to vote on proposed modification of a euro area government's debt securities and, in the unlikely event this is not the case, the "apparent indifference of the absent bondholders can fairly be understood as constituting their silent acquiescence to the proposed modification."¹¹ We believe the Committee dismisses these concerns too readily, as there may be a variety of legitimate reasons that a quorum may not be achieved. Due to their fundamental importance, reserved matters should be subject to a consistently high approval threshold, regardless of whether they are approved at a meeting or by written resolution.

Cross-Series Modification

The Draft CAC includes several mechanisms relating to cross-series modification, or aggregation. We appreciate that the Committee has included these important provisions. We believe these provisions would benefit, however, from greater clarity and detail, so that bondholders can better assess, at the time they purchase bonds, how these aggregation provisions would operate under different circumstances. We also believe that the approval thresholds for cross-series modification, as we discuss above for single-series modification, should be higher.¹² In addition, we recommend that the Committee not include the partial cross-series modification provision. The partial cross-series modification provision is intended to provide an approval mechanism in circumstances in which a

⁸ See, e.g., ICMA Standard CAC, *supra* note 4 (75% threshold for reserved matters and 66 2/3% for non-reserved matters); G-10 Report, *supra* note 2 (75% threshold for reserved matters and 66 2/3% for non-reserved matters).

⁹ Cf. ICMA Standard CAC, *supra* note 4 (approval threshold for reserved matters based on the aggregate principal amount of outstanding bonds).

¹⁰ For example, under the Draft CAC quorum provision, less than 45% of bondholders could approve a reserved matter at a first meeting, and less than 17% of bondholders in the event of an adjournment.

¹¹ Explanatory Note, *supra* note 1, at 4.

¹² The Draft CAC generally includes the same thresholds for cross-series approval as for single series approval, with additional requirements relating to series approval. See Draft CAC Clause 2.2.

proposed cross-series modification is not approved in relation to a reserved matter, but would have been approved if the proposed modification had involved only certain series of the bonds.¹³ We believe that, as drafted, this provision is unclear. It also creates uncertainty for bondholders, because of the multiple potential outcomes of a vote and the broad discretion granted to a sovereign issuer to determine the outcome of a vote under these circumstances.

Reserved Matters

The list of reserved matters is critical to the strength of a CAC. The Committee has included in the Draft CAC a list of reserved matters that is fairly broad. Change of law is a reserved matter, but only if the bonds are governed by a foreign law. We recommend that change of law be a reserved matter in all instances, as the law governing a bond is an important term to an investor and should be subject uniformly to a higher voting threshold. We also recommend, consistent with our recommendation below on adding clauses regarding acceleration and withdrawal of acceleration, that reserved matters also include any change to the bonds describing circumstances in which bonds may be declared due and payable prior to their scheduled maturity date.

Disenfranchisement and Related Issues

Disenfranchisement provisions in CACs provide important protections to bondholders, by seeking to prevent the sovereign issuer or entities it controls from influencing the outcome of a vote. These and similar concerns may be heightened in the euro area because of the close inter-relationships among EU Member States, which may motivate one Member State or its agencies to take actions to protect the interests of another Member State whose bonds it holds. Supranational agencies or authorities in the EU that hold bonds issued by a Member State also may be motivated to protect the interests of particular Member States whose bonds they hold. These inter-relationships among Member States present additional risks for investors to consider when investing in EU sovereign debt, and highlight the need for strong disenfranchisement provisions. In particular, we recommend that the Commission consider expanding the disenfranchisement provision also to encompass supranational EU agencies or authorities. The risks presented by these inter-relationships also heighten the need for other strong bondholder protections in a CAC, including a sufficiently high approval threshold measured on the basis of the aggregate principal amount of outstanding bonds, as we discuss above.

A particular concern we had regarding the disenfranchisement provision in the Draft CAC is the exclusion it provides from bonds considered to be disenfranchised for entities with “autonomy of

¹³ Draft CAC Clause 2.3.

decision.”¹⁴ While we understand the rationale for this exclusion, we believe it is broad and potentially subjective. We therefore recommend that the Committee consider eliminating this proposed exclusion.

If the Committee nonetheless retains the autonomy of decision exclusion, we recommend that it provide for further transparency relating to designation of such entities. Under the Draft CAC, the issuer must publish a non-exhaustive list of entities with autonomy of decision no less than five days prior to the record date for a modification.¹⁵ Not only does this fail to give bondholders sufficient time to consider such a list, but it gives them no recourse prior to a vote, in the event that they disagree with the issuer’s designation of a particular entity as having autonomy of decision.

Bondholder Representation

The Draft CAC does not provide for any type of bondholder representation. Designation in a CAC of a specific party to act for investors provides important protections to bondholders, and may facilitate the ability of a sovereign issuer to communicate effectively with investors.¹⁶ International government and self-regulatory organizations have recommended bondholder representative or bondholder committee clauses for sovereign debt because of the benefits they offer.¹⁷ We therefore recommend that the Committee add a provision to the Draft CAC allowing for the appointment of a bondholder representative or similar entity.

¹⁴Draft CAC Clause 2.6(c). A holder of a bond has “autonomy of decision:”

... if, under applicable law, rules or regulations and independent of any direct or indirect obligation the holder may have in relation to the Issuer:

- (x) the holder may not, directly or indirectly, take instruction from the Issuer on how to vote on a proposed modification; or
- (y) the holder, in determining how to vote on a proposed modification, is required to act in accordance with an objective prudential standard, in the interest of all of its stakeholders or in the holder’s own interest; or
- (z) the holder owes a fiduciary or similar duty to vote on a proposed modification in the interest of one or more persons other than a person whose holdings of Bonds . . . would be deemed to be not outstanding under this Section [].

Draft CAC Clause 2.6(c)(iii).

¹⁵Draft CAC Clause 2.8.

¹⁶ See G-10 Report, *supra* note 3.

¹⁷ *Id.*; ICMA Standard CAC, *supra* note 4.

Bondholder Meetings

The Draft CAC provides that a bondholder meeting may be convened anytime by the sovereign issuer, and that the issuer is obligated to convene a meeting if an event of default occurs and is continuing and a meeting is requested by holders of not less than 10% of the aggregate principal amount of the outstanding bonds.¹⁸ We are concerned that this provision may unduly restrict the ability of bondholders to convene meetings, especially under circumstances in which an issuer in default does not comply with its obligations.¹⁹ We recommend that the Committee broaden this provision to make it more consistent with bondholder meeting provisions that are standard in CACs in the international sovereign debt markets.

We also note that the Draft CAC provides for a shorter time period for providing notice of a meeting than is standard in CACs typically used in the international sovereign debt markets.²⁰ This shorter time period may make it difficult, especially for foreign investors holding through intermediaries, to participate in an issuer vote. We therefore recommend that the Committee revise the Draft CAC to provide a time period for notice of a meeting that is more consistent with market standards.

Acceleration and Withdrawal of Acceleration

The Draft CAC does not include clauses providing for acceleration and withdrawal of acceleration, which provide an important enforcement mechanism to bondholders in the event of default. A withdrawal of acceleration clause also may prove useful to a sovereign issuer in the course of a restructuring.²¹ An acceleration clause typically provides that if an event of default occurs and is continuing, bondholders, generally at least 25% of the aggregate principal amount of the outstanding bonds, may declare (by written notice to the issuer) the bonds to be immediately due and payable.²² A withdrawal of acceleration clause allows bondholders, typically at least 50% of the aggregate principal

¹⁸ Draft CAC Clause 4.2.

¹⁹ For example, under the ICMA Standard CAC, a meeting may be convened by the issuer or fiscal agent at any time upon the request in writing of holders of at least 10% of the aggregate principal amount of the outstanding bonds.

²⁰ The Draft CAC provides for a 21 day notice period for convening a meeting. We understand a 30 day period is more typical.

²¹ See G-10 Report, *supra* note 3, at 6.

²² See, e.g., ICMA Standard CAC, *supra* note 4.

Mr. Philippe Mills
September 12, 2011
Page 7 of 7

amount of the outstanding bonds, to declare that the relevant event of default has been cured, and withdraw the declaration of acceleration.²³

We recommend that the Committee add clauses providing for acceleration and withdrawal of acceleration to the Draft CAC. We also recommend that the Committee include them as reserved matters.

Governing Law

We understand that the Committee gave careful consideration to which law should govern the standardized CAC before proposing that it be governed by the law that governs the bond more generally. We realize that there is no easy solution to this issue. While the Committee seeks to achieve consistency for the standardized CAC,²⁴ there is tension between having the governing law of the bonds and CACs issued in a particular jurisdiction be consistent, and having the governing law for the standardized CAC be consistent. Under the Committee's proposal, there is a risk that the standardized CAC will be subject to inconsistent enforcement and different interpretations across jurisdictions. Such a result could cause confusion and uncertainty for investors. While we do not necessarily recommend a different approach, we suggest that the Committee consider whether it may be possible to develop mechanisms that would facilitate consistent interpretations of the standardized CAC across jurisdictions.

* * *

We appreciate the opportunity to provide comments on the Draft CAC. If you have any questions about our comments or would like additional information, please feel free to contact me directly at (202) 326-5813 or Sarah Bessin at (202) 326-5835.

Sincerely,

/s/

Susan Olson
Senior Counsel

²³ *Id.*

²⁴ Indeed, one of the goals of the EU in developing a standardized CAC is to “have uniformity of application and provide a level playing field for all euro area Member States . . .” Explanatory Note, *supra* note 1, at 1.