Restructuring Sovereign Debt

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This paper presents an introductory roadmap to sovereign debt restructurings. A sovereign restructuring is the complicated, often painful, and sometimes protracted process by which a sovereign, its citizens, and its creditors accept present losses to increase the sovereign's ability to pay its debts. While not common, sovereign restructurings have occurred often enough that the process can be summarized and given in outline. Ecuador, Argentina, and the Province of Buenos Aires have all restructured their debts in the past year and a half, while Greece conducted the largest sovereign debt restructuring in history within the past decade. All these restructurings, and others, typify the restructuring process.

This paper comes at an interesting time for sovereign debt. The widely recognized growth in sovereign debt balances has been matched by a less recognized proliferation of creditor types. Forty years ago, the picture was clearer. Loans came from traditional and governmental Paris Club lenders or from traditional and institutional London Club banks – with the occasional regional bank as a hanger-on. Today, loans from 'non-traditional' sources have overtaken these funding sources. China has become the largest lender for many countries. Non-bank financial institutions have begun to muscle into sovereign lending. Diffused crowds of bondholders have replaced banks as a principal source of finance. None of this is to say that traditional sources of finance have disappeared. They are just smaller. All this leaves a restructuring sovereign at the mercy of complexity. So many interests must be balanced, so many incentives obeyed, and so many egos assuaged that a sovereign must perform its part perfectly or risk stumbling at every stage of the process.

In the following sections, this paper will introduce the basics of sovereign debt restructuring. It begins with a discussion of the character and incentives of the main actors in the process. It then covers some preliminary steps and considerations for a sovereign before delving into the main methods used to restructure sovereign debt. The paper proceeds to look at the bargaining process and some bargaining techniques used in a sovereign restructuring. It concludes with a review of restructuring outcomes such as duration, haircuts, and holdouts.

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