ORTUZ LAWYER'S OFFICE

<u>Buybacks</u>

The existence of a secondary market in a sovereign's debt obligations could trouble the creditors if the sovereign has the legal capacity or the funds, required to benefit from the discounts on its own paper prevailing in this secondary market (BUCHHEIT, Lee C., Moral hazard and other delights, *IFLR*, April 1991; BUCHHEIT, Lee C., Exchanging places, *IFLR*, May 1991). The sovereign may seek to repurchase the paper in the secondary market, or engage in discounted exchanges of old debt for new (better quality) paper, and thus realise the benefit of the discount for itself.

What reasons are there why a sovereign borrower could not legally repurchase its own debt:
1. waiver from its commercial bank creditors to sell, or
2. clauses or provisions in reconstructing and new money agreements.

Two provisions are used in reconstructing and new money agreements to prohibit the sovereign borrower not to purchase its own debt:
1. the mandatory prepayment restriction
2. the sharing clause.

<u>Mandatory prepayment restriction</u>: the borrower is required to make a mandatory prepayment of all of its restructured debt if it elects to repay any specific item of that indebtedness (or certain categories of that debt) in advance of the rest. This clause precludes the borrower from paying one item of indebtedness ahead of the others.

<u>Sharing clause</u> purports to require any bank, which receives a disproportionate payment of its loan to share that payment with the other lenders in its restructuring syndicate. This clause prevents the borrower from making disproportionate payments to one lender without paying the others.

These clauses were never intended to safeguard against a sovereign's attempting to benefit from the discounts on its own paper prevailing in that market. Moreover, a sovereign does not need to openly repurchase its own paper in the secondary market. It could instead nominate a third party to acquire and hold that paper for the benefit of (and with funds indirectly supplied by) the sovereign under some form of subparticipation arrangement. These are *indirect debt buybacks*.