November 2015

Weil

Ukraine's Sovereign Restructuring: Why is this sovereign deal ground-breaking?

As settlement in relation to Ukraine's successful sovereign exchange offers is expected today, we explain why this sovereign deal is ground-breaking.

Background: The Exchange Offers

On 22 September 2015, Ukraine launched Exchange Offers in relation to the following (Old Notes):

- *Sovereign Bonds:* 11 series of Eurobonds issued by Ukraine due to mature between 2015 and 2023; and
- *FininPro Bonds:* 3 series of Eurobonds issued by the State Enterprise for the Financing of Infrastructural Projects due to mature in 2017 and 2018.

In exchange for each $1,000 of Old Notes, creditors will receive:

- *$800 of New Notes:* broadly speaking creditors will receive a rateable allocation of 9 equal series of New Notes with maturities from 2019 through to 2027; and
- *$200 of GDP-linked Securities.*

Upside Instruments: The GDP-linked Securities

The terms of the exchange provide creditors with a mechanism whereby they can potentially recover not only the amount of the haircut, but share in the economic recovery of Ukraine if certain GDP targets are met.

Through the GDP-linked Securities creditors are entitled to payments (beginning in 2021 annually, through to 2040) depending on Ukraine's growth. Payments are triggered if annual growth:

- is between 3-4%; then payment will be 15% of the real GDP growth exceeding 3%.
- exceeds 4%; then payment will be 40% of the growth beyond 4%, in addition to the amount for 3-4% growth described above.

Payments are capped at 1% of GDP from 2021 to 2025 and no GDP payments:

- if Real GDP Growth Rate in Reference Year is less than or equal to 3%; or
- if GDP at Current Prices in a Reference Year is less than the hryvnia equivalent of $125.4 billion.

What distinguishes these GDP-linked Securities from others is the following:

- *Covenant Protections:* Very few existing GDP-linked Securities have extensive covenants. The covenants are designed to protect holders against GDP manipulation, dilution and subsequent invalidity.
- *Cross-default provisions from the GDP-linked Securities into the New Notes:* Breach of certain covenants will trigger cross-defaults into New Notes and allow them to be accelerated.
- *Put Option:* The put option enables creditors to require Ukraine to repurchase the GDP-linked Securities at a price equal to their notional amount. In other words, it enables creditors to be made whole in relation to the haircut.

According to Deutsche Bank Market Research these creditor protections "*enhance the value of the [GDP-linked Securities], as they put in some specific creditor protection mechanisms that were absent (or more ambiguous) in some comparable securities, such as the Argentina GDP warrants.*"[1] In particular, the put option, which enables holders of the GDP-linked Securities to claim par in certain circumstances, "*is a pure innovation in design of the Ukraine [GDP-linked Securities]*[1]."

New provisions for holdouts

The exchange offers were designed to encourage participation and to prevent the form of hold-out strategy pursued by certain funds in Argentina. This included:

- *Most favoured Creditor Clause:* Ukraine is prohibited from settling with holdouts (including Russia) on more favourable terms than the New Notes. If this clause is breached, it will trigger an Event of Default under the New Notes.

- *Loss of GDP-linked Securities:* Holdouts also lose out on the GDP-linked Securities.
- *Local legislation:* Local legislation was enacted to enable those creditors who participated in the exchange offer to have priority in payment over those creditors who did not participate.
- *No ability for Ukraine to accept/reject exchange offers on a per-series basis:* This all or nothing approach was intended to prevent cherry picking by Ukraine and provide creditors who held bonds across multiple series with certainty as to the overall restructuring (rather than being left with partially-restructured debt across a number of different series).

Protections against holdouts going forward: Collective Action Clauses (or CACs)

Old Notes (Per Series): Old Notes contained per series CACs. In each series, if 75% in value voted in favour of the respective exchange offer, all holders in that series would be exchanged whether or not they voted in favour or against.

New Notes (Cross Series): New Notes contain the International Capital Market Association's (ICMA) recommended CACs. This allows a super-majority across all series of New Notes to agree changes to bond terms that are then binding on all holders. Going forward this allows Ukraine to effectively treat all New Notes as a single group, removing the threat posed by holdouts.

For a further discussion of the new ICMA standard CACs, please see "Recent developments in sovereign debt restructuring: a step in the right direction?" by Kirsten Erichsen and Andrew J. Wilkinson dated 12 February 2015 http://eurorestructuring.weil.com/sovereign-debt/recent-developments-in-sovereign-debt-restructuring-a-step-in-the-right-direction/

[1] Deutsch Bank Market Research Analyst Reports: (i) "Ukraine – Pricing the GDP Warrants" dated 16 September 2015; and (ii) "Ukraine: Pricing GDP Warrants, Part II – Discounting the Cash Flows" dated 9 October 2015