



Consultation Draft
April 10, 2014

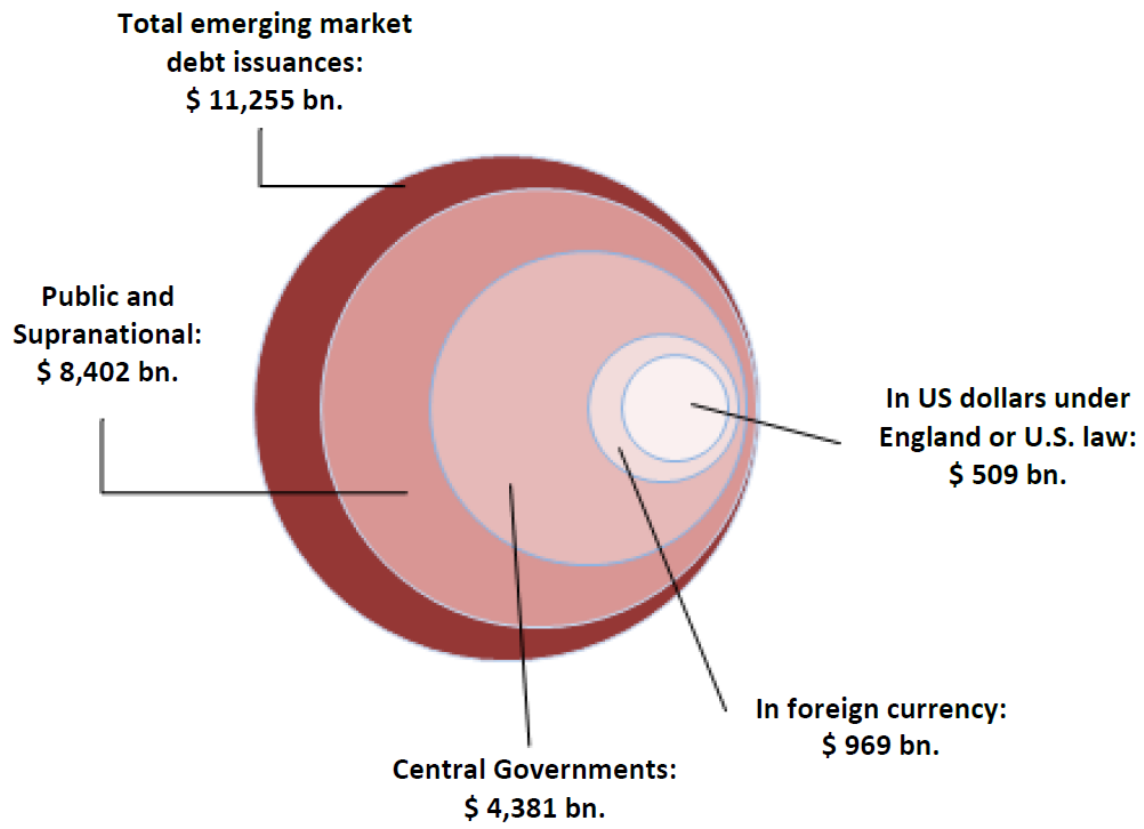
Emerging Market Sovereign Bonds: Does It Cost More To Issue Under English Law?

Sergio Kurlat and Dilip Ratha
Development Prospects Group
The World Bank



Introduction

Central Government dollar-denominated bonds issued under English or American jurisdiction represented a large component of EM debt capital markets in 1990-2012:



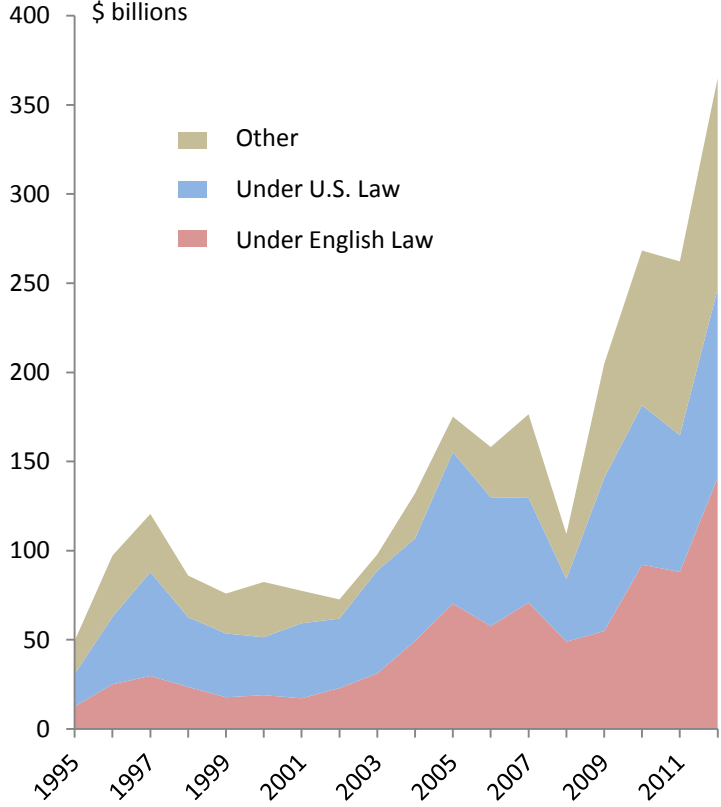
Note: circle areas represent volume issued



Introduction

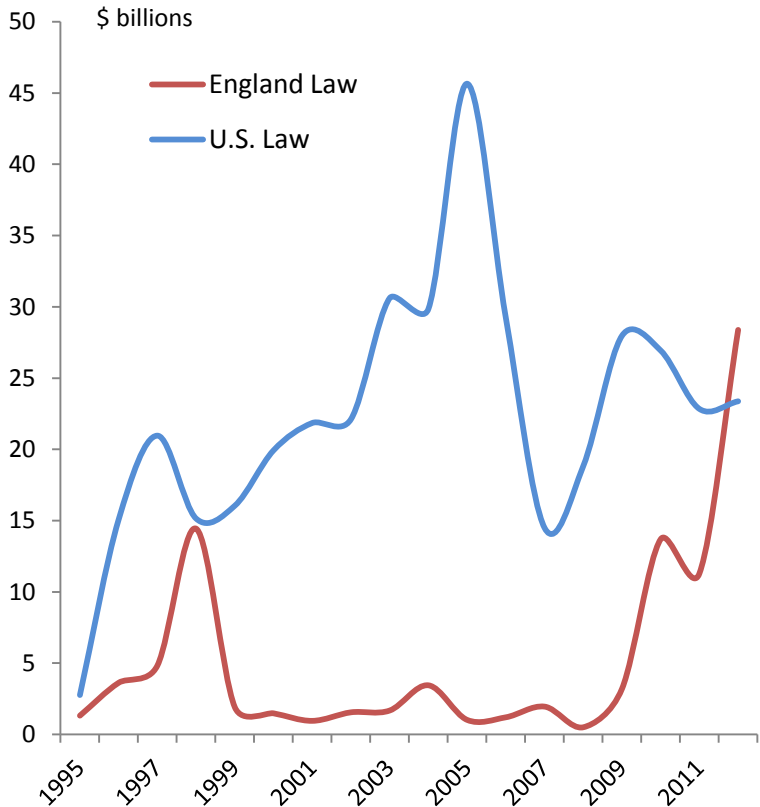
Introduction

More foreign currency EM bonds (public and private) issued under English law after the crisis



Total EM foreign currency issuances (1990-2012): \$ 2,737 bn.

English jurisdiction overtook U.S. in EM Central Govt USD bond issuances



Total EM Central Gov't dollar issuances (1990-2012): \$ 509 bn.

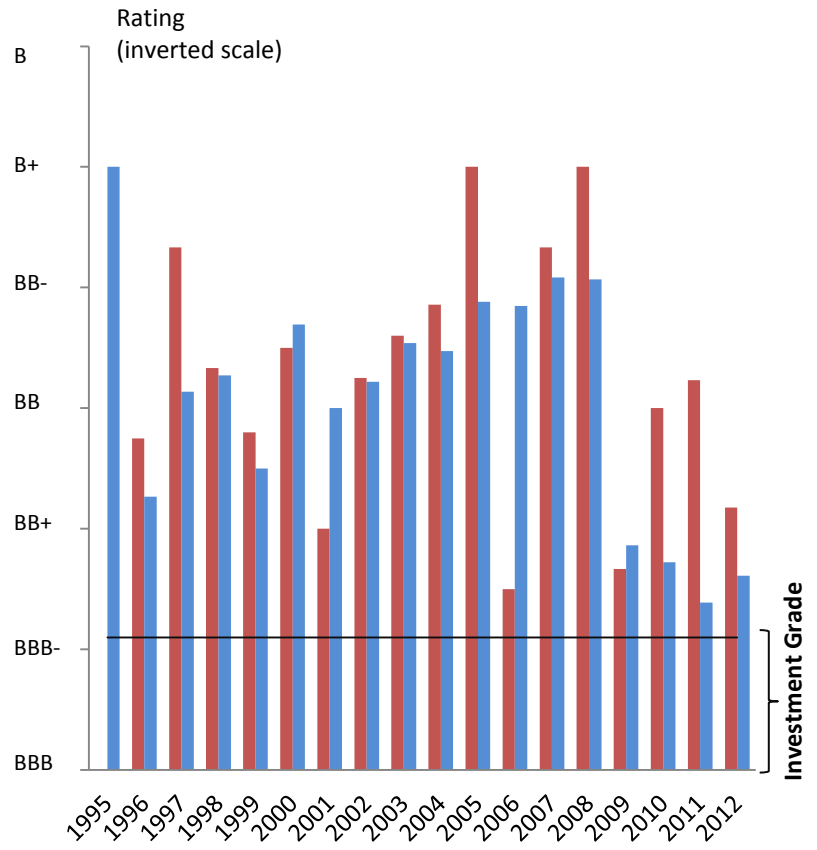
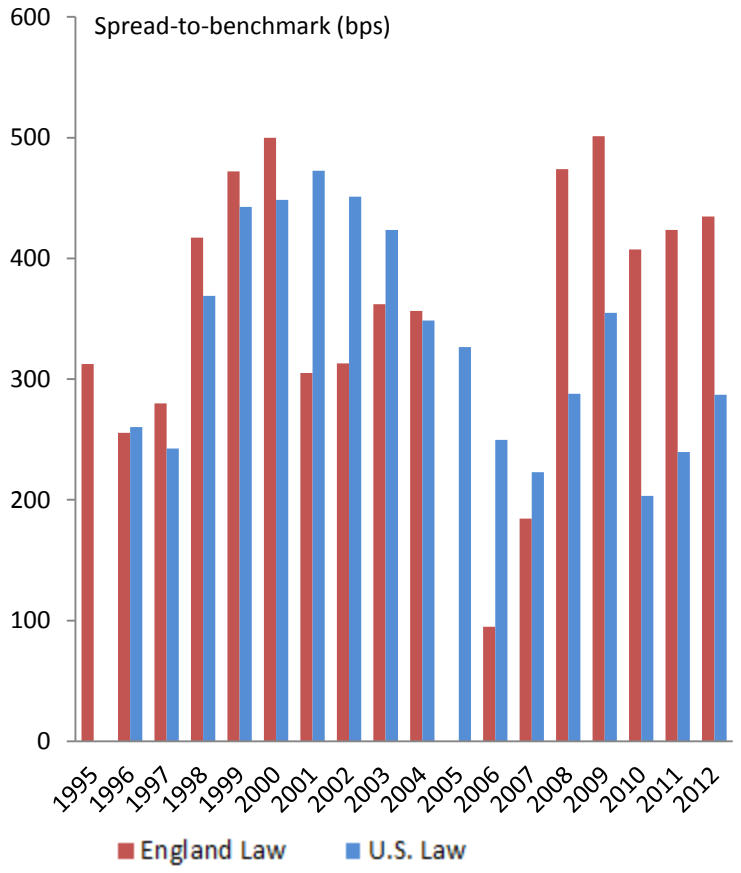


Introduction

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Spreads at launch of bonds under English governing law got higher compared to bonds under U.S. jurisdiction...

...which can't be explained by the modest worsening of their relative ratings





The legal background

The legal background

The ability to move jurisdiction to courts in advanced countries has contributed to the development of the EM sovereign debt market

- Governing law doesn't have to coincide with place of performance (the default) or place of contracting
- Contracting parties can select London or New York jurisdiction even if transactions have no real connection with location
- U.S. and U.K. laws allow waiver of sovereign immunity (incl. execution of assets)

In practice, for this category of bonds, the legal jurisdiction usually differs from the listing location at launch (the home market). Most of these bonds are actually issued in Luxembourg:

Number of emerging market central government dollar-denominated bonds by legal jurisdiction and listing location of first tranche (full dataset)		
Home market (not mutually exclusive)	Under U.S. law	Under English law
Listed in U.S.	10	1
Listed in U.K.	11	14
Listed in another foreign market	377	125
Listed locally	32	2



The legal background

Example No. 1: Latvia 5.25% 2017: listed in Luxembourg, governed by English law:



REPUBLIC OF LATVIA,
ACTING THROUGH THE TREASURY

U.S.\$1,000,000,000

5.250 PER CENT. NOTES DUE 2017

Application has been made to list the Notes on the Official List of the Luxembourg Stock Exchange and to admit the Notes to trading on the Luxembourg Stock Exchange's regulated market pursuant to the rules and regulations of the Luxembourg Stock Exchange.

SUMMARY OF THE TERMS OF THE NOTES

Governing Law:	The Notes and any non-contractual obligations arising out of or in connection with the Notes are governed by and shall be construed in accordance with English law, provided, however, that the due authorisation and execution of the Notes by and on behalf of the Republic shall be governed by the laws of the Republic.
Form and Denomination:	The Notes will be issued in registered form in denominations of U.S.\$200,000 and integral multiples of U.S.\$1,000 in excess thereof.
Credit Ratings:	The Notes have been assigned a rating of BBB- by Fitch, Baa3 by Moody's and BB+ by S&P. Fitch, Moody's and S&P are established in the European Union and are registered under the CRA Regulation

The legal background



The legal background

Example No. 2: Uruguay 4.125% 2045: listed in London, governed by New York law:



República Oriental del Uruguay

Invites the Owners of
Each Series of Bonds listed on the inside front cover
(collectively, the "Eligible Bonds")
to submit offers to
exchange Eligible Bonds
for
U.S. Dollar Global Bonds due 2045 (the "New Bonds due 2045")

Each offer to exchange any series of Eligible Bonds is made as a separate, independent offer.
Uruguay reserves the right, in its sole discretion, not to accept tenders of one or more series of Eligible Bonds.
The aggregate outstanding principal amount of all Eligible Bonds is approximately US\$5.2 billion.
Eligible Bonds tendered for New Bonds due 2045 may be subject to proration as described herein.

This prospectus supplement and the accompanying prospectus are together referred to as the "Invitation Materials."
Transactions contemplated by the Invitation Materials are referred to as the "Invitation."

Listing	Application will be made to admit the New Bonds due 2045 to the Official List of the UKLA and to admit the New Bonds due 2045 to trading on the Regulated Market of the London Stock Exchange. The Regulated Market is a regulated market for the purposes of the Markets in Financial Instruments Directive (Directive 2004/39/EC).
Governing Law and Jurisdiction	New York.

The legal background



The legal background

Most authors consider collective action clauses the most relevant legal characteristic defining a jurisdiction, with potential effects on bond spreads. CACs are normally associated with English law.

Unlike previous authors, we have data at the individual security level showing that bonds under U.S. law are now just as likely to contain CACs:

Number of emerging market central government dollar-denominated bonds containing CACs (2008-2012)			
		Under U.S. law	Under English law
With collective action clause		73	22
Without collective action clause		17	11
<i>Proportion with CACs</i>		<i>81%</i>	<i>67%</i>



Model

$$\begin{aligned} \ln(\text{Spread})_{it} = & \alpha + \beta_1 IG_{it} + \beta_2 S\&P_{it} + \beta_3 \ln(\text{Size})_{it} + \beta_4 \text{Maturity}_{it} \\ & + \beta_5 \text{EnglandLaw}_i + \beta_6 VIX_t + \beta_7 \text{Growth}_{j,t-1} \\ & + \beta_8 \text{Region}_j + \beta_9 \text{Year}_t + u_{it} \end{aligned}$$

Spreads at launch are explained by:

- Security-specific variables (investment grade, rating, size, maturity)
- Governing law dummy
- Macroeconomic factors (volatility, country GDP growth)
- Control dummies (region, year)



Main Results

Dependent variable: Log of spread-to-benchmark at launch

	Full sample	Pre-crisis	Post-crisis
IG dummy	-0.301*** (-3.79)	-0.319*** (-3.61)	0.172 (0.80)
S&P Rating	0.112*** (5.83)	0.136*** (6.20)	0.108** (2.63)
Log(size)	0.104** (2.12)	0.056 (1.13)	0.059 (0.85)
Number years to maturity	0.005* (1.87)	0.012*** (3.78)	-0.010** (-2.52)
England Law	0.149* (1.86)	0.002 (0.01)	0.295*** (3.11)
VIX	0.018*** (3.71)	0.013** (2.28)	0.027*** (5.09)
GDP growth (t-1)	-0.014** (-2.13)	-0.012 (-1.52)	0.012 (0.76)
Observations	421	317	104
R ²	0.591	0.666	0.640

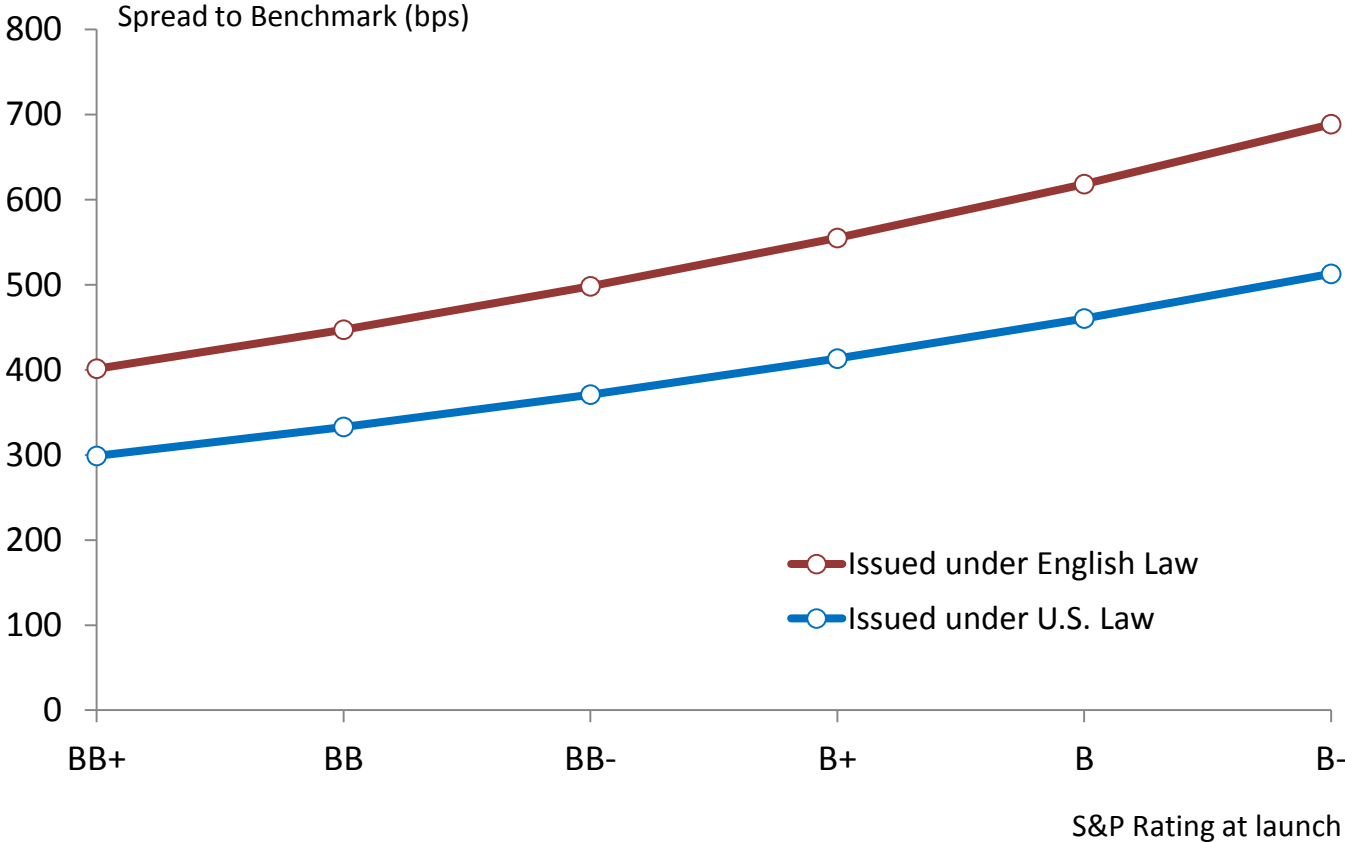
Constant term, region and year dummies included but not reported



Main Results

Moving from American to English jurisdiction increases spreads by one-third, equivalent to a three-notch downgrade:

Predicted spread at launch of a \$100 million dollar-denominated 7-year African sovereign bond, 2008-2012





Results With CACs

Dependent variable: Log of spread-to-benchmark at launch

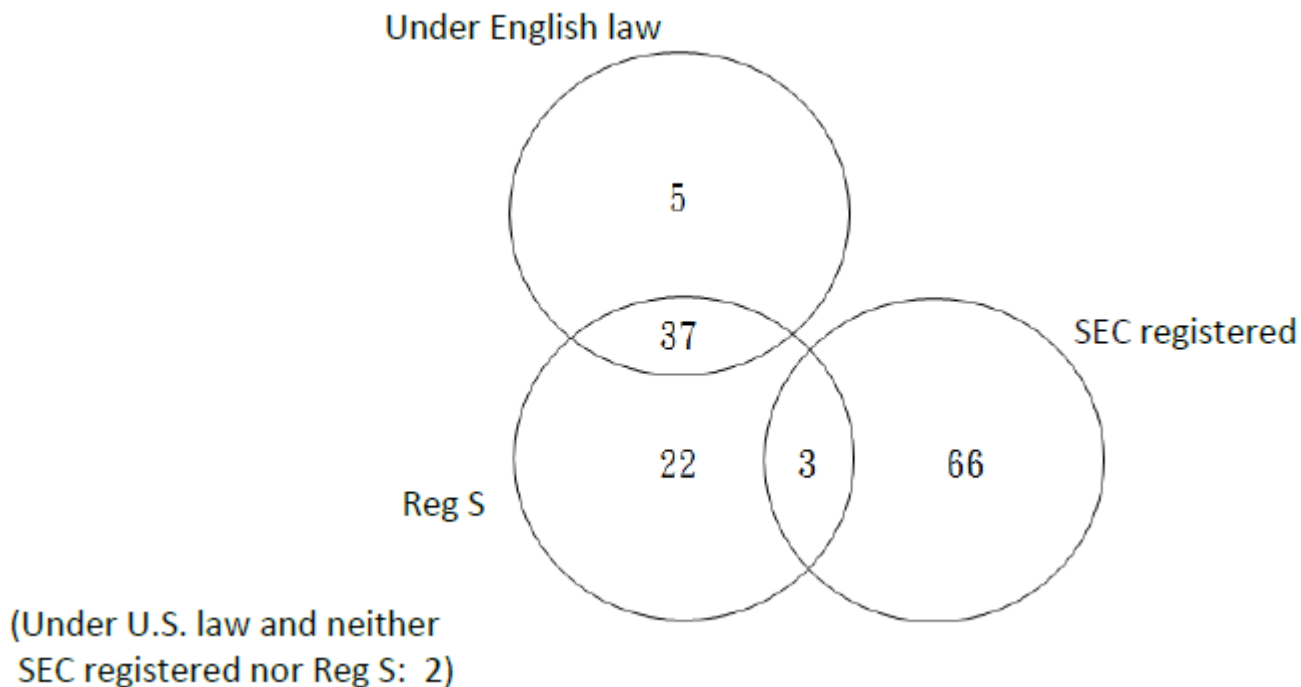
	Full sample	Pre-crisis	Post-crisis
IG dummy	-0.343*** (-3.94)	-0.318*** (-2.78)	-0.000 (-0.00)
S&P Rating	0.080*** (4.51)	0.128*** (6.12)	0.069** (2.14)
Log(size)	0.056 (1.64)	0.024 (0.65)	0.045 (0.60)
Number years to maturity	0.002 (0.64)	0.008** (2.52)	-0.008** (-2.02)
England Law	0.333*** (4.37)	0.135 (1.16)	0.370*** (3.90)
VIX	0.021*** (4.23)	0.020*** (2.80)	0.027*** (5.10)
GDP growth (t-1)	-0.015** (-1.98)	-0.005 (-0.45)	-0.001 (-0.14)
Collective action clause	0.176*** (2.88)	0.155** (2.36)	0.025 (0.19)
Observations	309	218	91
R ²	0.615	0.691	0.717

Constant term, region and year dummies included but not reported



Results With SEC Registration

In the post-crisis period, almost all bonds under English law were Reg S, while most bonds under U.S. law were SEC registered. One must establish which one out of these overlapping characteristics was the decisive factor:





Results With SEC Registration

Dependent variable: Log of spread-to-benchmark at launch

	Full sample	Pre-crisis	Post-crisis
IG dummy	-0.297*** (-3.70)	-0.324*** (-3.59)	0.177 (0.90)
S&P Rating	0.111*** (5.85)	0.138*** (6.33)	0.100*** (2.75)
Log(size)	0.108** (2.15)	0.047 (0.91)	0.018 (0.27)
Number years to maturity	0.005* (1.93)	0.012*** (3.69)	-0.010** (-2.46)
England Law	0.112 (1.31)	0.038 (0.37)	-0.006 (-0.03)
VIX	0.018*** (3.71)	0.014** (2.34)	0.030*** (5.54)
GDP growth (t-1)	-0.015** (-2.26)	-0.012 (-1.45)	0.016 (0.97)
SEC registered dummy	-0.045 (-0.83)	0.065 (1.10)	-0.383* (-1.79)
Observations	419	317	102
R ²	0.591	0.668	0.669

Constant term, region and year dummies included but not reported



Results With First-Time Issuers

The fact that most first-time issuers opt for English jurisdiction (especially African and East European governments) is a connected, but not dominant, factor:

	Governments issuing for the first time dollar-denominated bonds under English/American jurisdiction				
Region	1990-2007	of which: under English law		2008-2012	of which: under English law
East Asia & Pacific	4	50%		2	50%
Europe & Central Asia	13	92%		3	100%
Latin America & Caribbean	10	0%		0	-
Middle East & North Africa	4	50%		1	100%
South Asia	2	100%		0	-
Sub-Saharan Africa	4	50%		5	80%



The secondary market

Dependent variable: Log of spread-to-benchmark

	Post-crisis		
	After 60 days	After 90 days	After 180 days
IG Sovereign dummy	0.196 (0.98)	0.165 (0.84)	-0.039 (-0.26)
S&P Sovereign Rating	0.118*** (3.89)	0.112*** (3.87)	0.104*** (4.56)
Log(size)	0.004 (0.04)	-0.013 (-0.15)	-0.049 (-0.67)
Number years to maturity	-0.022*** (-2.86)	-0.022*** (-2.67)	-0.014*** (-3.42)
England Law	0.195** (2.29)	0.193* (1.97)	0.216** (2.42)
VIX (t-1)	0.023*** (3.32)	0.016*** (4.12)	0.011** (2.25)
GDP growth (t-1)	-0.000 (-0.03)	0.004 (0.42)	-0.006 (-0.78)
Observations	82	82	81
R ²	0.748	0.722	0.824

Constant term, region and year dummies included but not reported



Conclusion

Actionable items

- For policymakers: Reg S is not enough; SEC registration is the way to lower the cost of debt by tapping the American investor
- For investors: for a given risk level, bonds with SEC registration offer a lower return than a portfolio of bonds under English law and with only Reg S

Future research

- What factors limit full SEC registration?
- Why has the American investor suddenly become wary of buying bonds without SEC registration?