JUNE 2003

# THE INTRODUCTION OF COLLECTIVE ACTION CLAUSES IN UMS'S BONDS

# Agenda

# Mexico’s Collective Action Clauses

## Introduction

**Mexico’s adoption of CACs has added practical experience to theoretical debate over reforms of the international financial architecture**

**Goal of this presentation:**

- To share Mexico’s experience to shed light on debate over financial reform
- To highlight important practical considerations Mexico confronted
- To contrast evolution of Mexican CAC bonds vs Non-CAC bonds

**Practical considerations encouraged us to proceed cautiously**

# Mexico's Collective Action Clauses

## Why did Mexico decide to include CACs?

**Mexico is better off if the sovereign bond market works well.**

**Since late 1990's, market participants have had serious concerns about the sovereign bond market**

- How would a restructuring unfold?
- What role would official creditors play?

**Even though Mexico's creditworthiness is strong, lack of confidence in the sovereign bond market harms Mexico indirectly**

# Mexico's Collective Action Clauses

## Why did Mexico decide to include CACs?



**Confidence would not be restored by an SDRM**

- Design and ratification of SDRM would take a long time
- Investors would have doubts about role of supernational authority

**"Contractual" approach does not create such concerns**

- A large set of bonds already includes CACs
- Many examples of corporate bond restructurings with CACs
- Fundamental legal framework preserved

**Mexico has an interest in seeing market evolve in the direction of the contractual approach**

# Mexico’s Collective Action Clauses

## Why did Mexico move first?

**Risk that no other sovereign issuer would move**

– Uncertainties would linger

**Risk that another sovereign issuer would set a precedent**

– By moving first, we could design clauses most appropriate for Mexico

**Little risk that Mexico would pay a premium for CACs**

– Mexico’s investment-grade status

– Our CACs, on balance, left investors no worse and, perhaps, better off

# Mexico's Collective Action Clauses

## What clauses to include?

**A 75% threshold for changing most important bond terms appropriate**

- Especially as threshold applies bond-by-bond rather than across all bonds

**A higher threshold for important non-payment terms**

- Threshold raised from 2/3rds to 75% to amend important non-payment terms
- Address bondholder concerns about "coercive" exchange

**A wider definition of excluded bonds**

- Bonds owned or controlled, directly or indirectly, by UMS are excluded from voting

# Mexico's Collective Action Clauses

## What clauses to exclude?

**No aggregation mechanism**

- We support the principle that material changes to bonds should require super-majority consent of holders of all affected bonds
- Prefer simpler approach.
- Misgivings about principle of aggregation, especially across different classes of creditors (e.g., bondholders, commercial bank lenders, official creditors)

**No contractual obligation to provide economic/financial information**

- Mexico is committed to transparency, and supplies information according to IMF's SDDS
- But we believe market works better when issuers can choose whether or not to be transparent
- Do not want to preclude providing better information that might not conform to SDDS

# Mexico’s Collective Action Clauses

## How Did Mexico Introduce the CACs?

**The new changes were presented as part of new documentation**

**Mexico was sensitive to complaints that we were acting unilaterally**

- Public deliberations over CACs would have taken time to complete, with no guarantee of a balanced package of clauses.
- Private negotiations with a small number of investors would have furnished some investors with material non-public information.
- Investor groups had already made their positions known, with considerable precision.
- We relied on the advice of our legal counsel and our underwriters.

# Mexico's Collective Action Clauses

## How Did Mexico Market the New Bond?

**Marketing goals**

– Place the bond as efficiently as possible, minimizing Mexico's cost of funds

**12-year maturity**

– Appealed to heart of high-grade investor community, an important constituency for Mexico

– Did not compete directly with recently issued 10-year bond

**Extended marketing period**

– Mexico endeavored to provide investors with enough time to study CACs

– But did not want to take too much market risk, given bond-market volatility

– We formally launched and priced once we received a critical mass of positive feedback

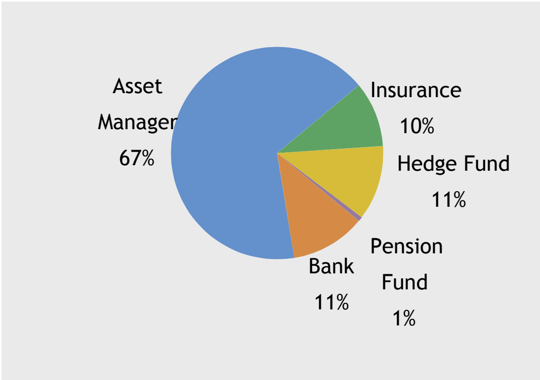
# Agenda

# The composition of UMS's investor base was not affected by the introduction of CACs



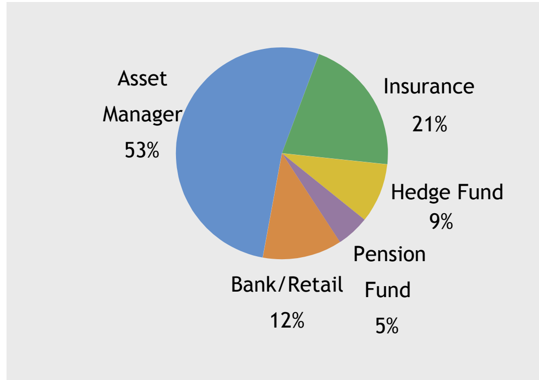
## UMS bonds with Collective Action Clauses - Distribution by investor type

### UMS '08 (Issued 4/8/03)



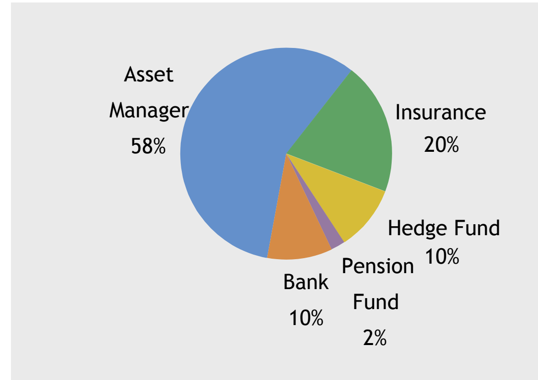

Source: JPMorgan

### UMS '15 (Issued 2/26/03)




Source: JPMorgan

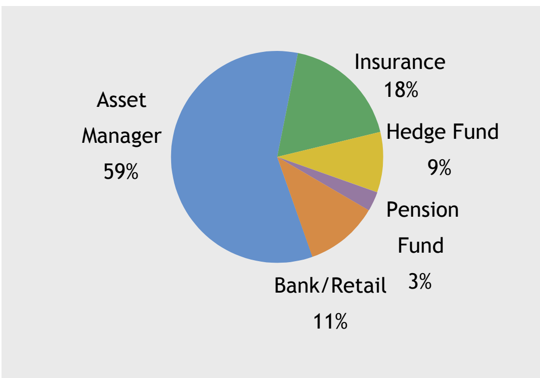
### UMS '33 (Issued 4/8/03)




Source: JPMorgan

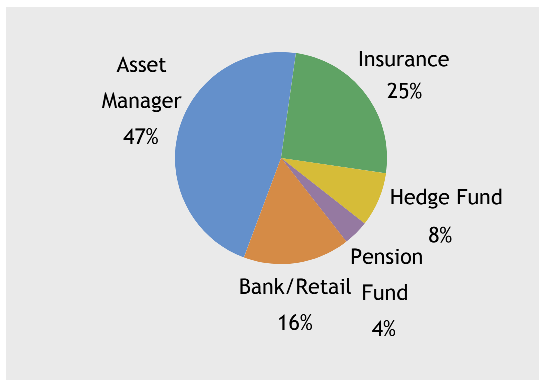
## UMS bonds without Collective Action Clauses - Distribution by investor type

### UMS '11 (Issued 1/8/01)



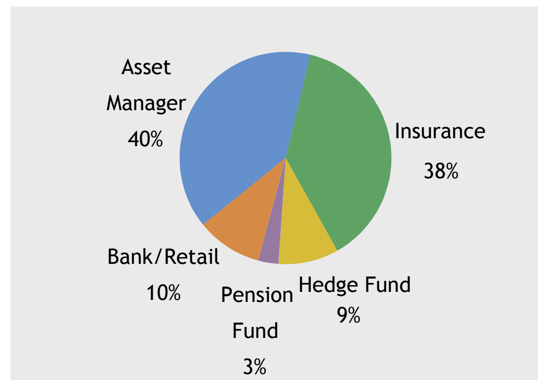

Source: JPMorgan

### UMS '13 (Issued 1/9/03)




Source: JPMorgan

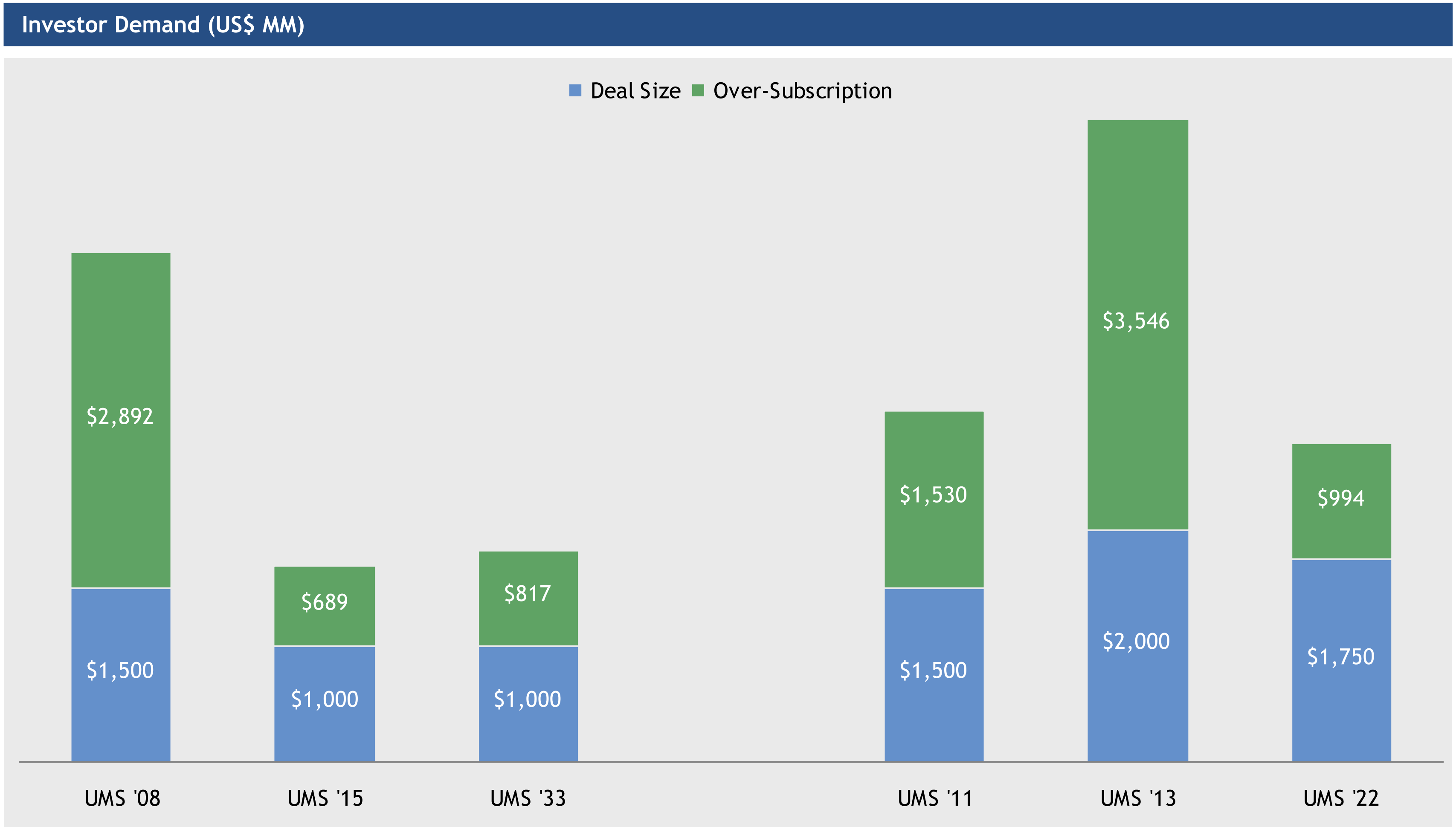
### UMS '22 (Issued 9/17/02)




Source: JPMorgan

# The over-subscription of the new bonds with CACs was in line with previous issues

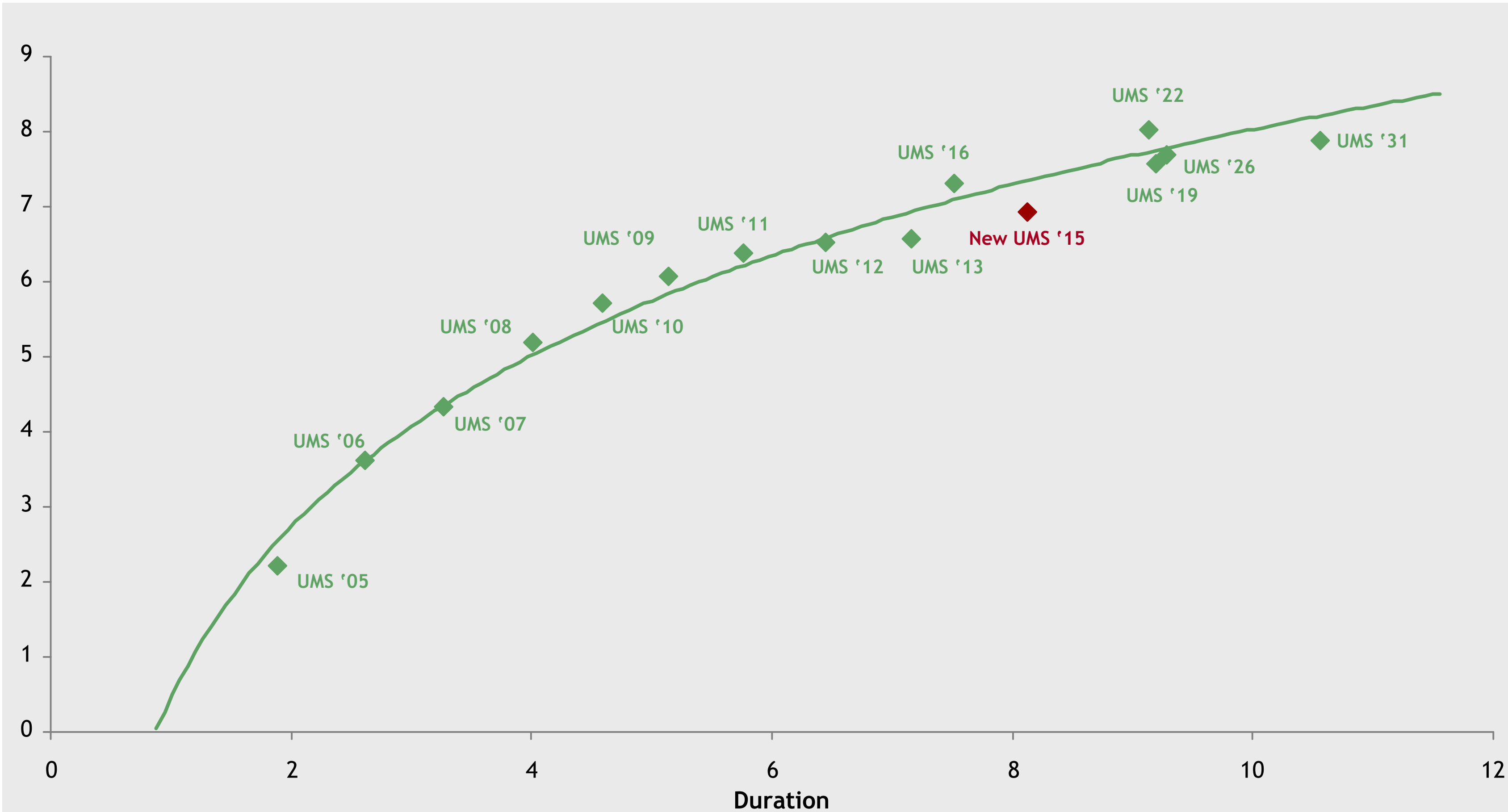





Source: JPMorgan

# The UMS 2015 was priced tight relative to UMS's existing curve

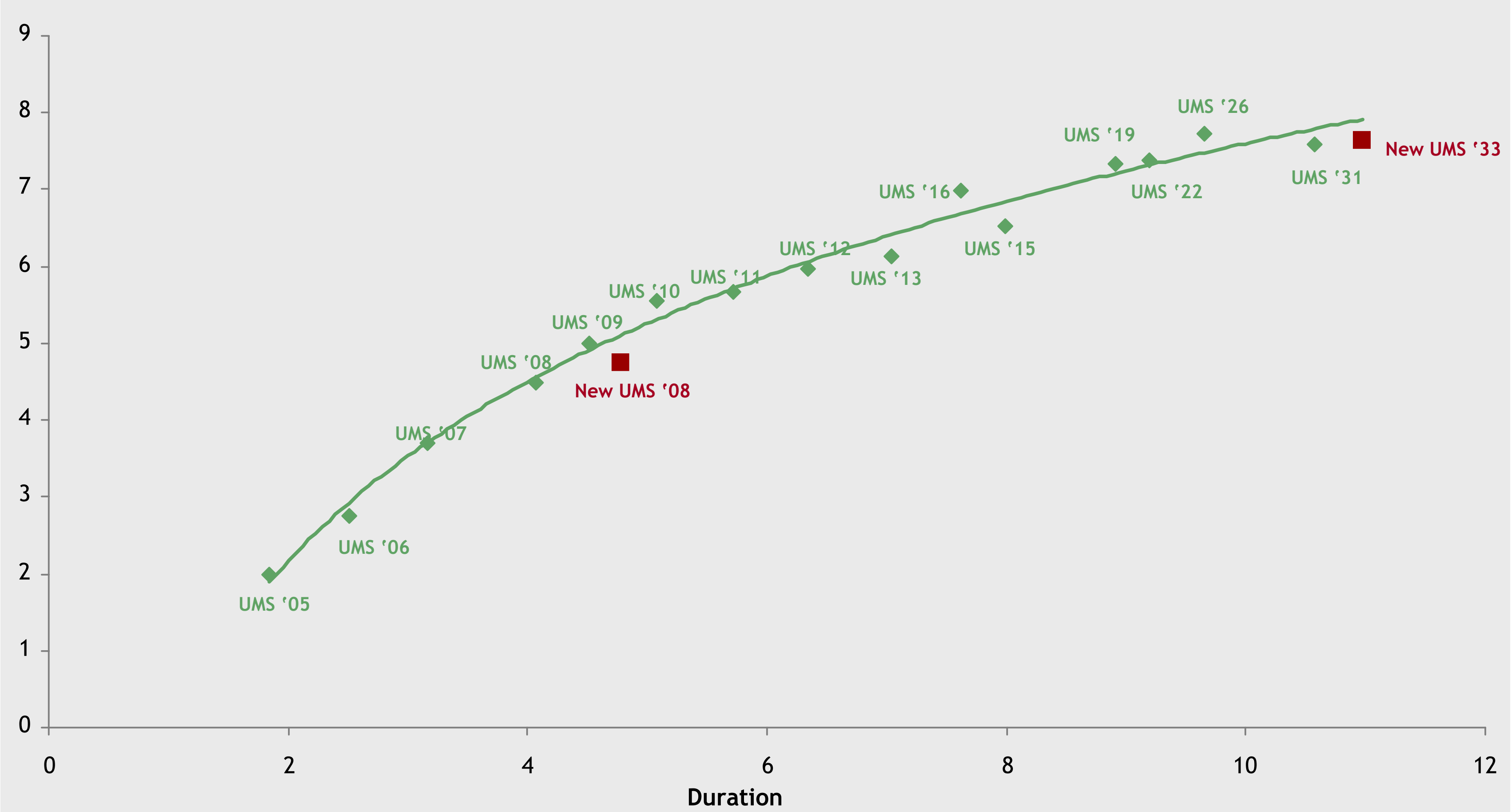
UMS Curve (Yield, %)




Source: JPMorgan

# The UMS 2008 and 2033 were priced tight relative to UMS's existing curve

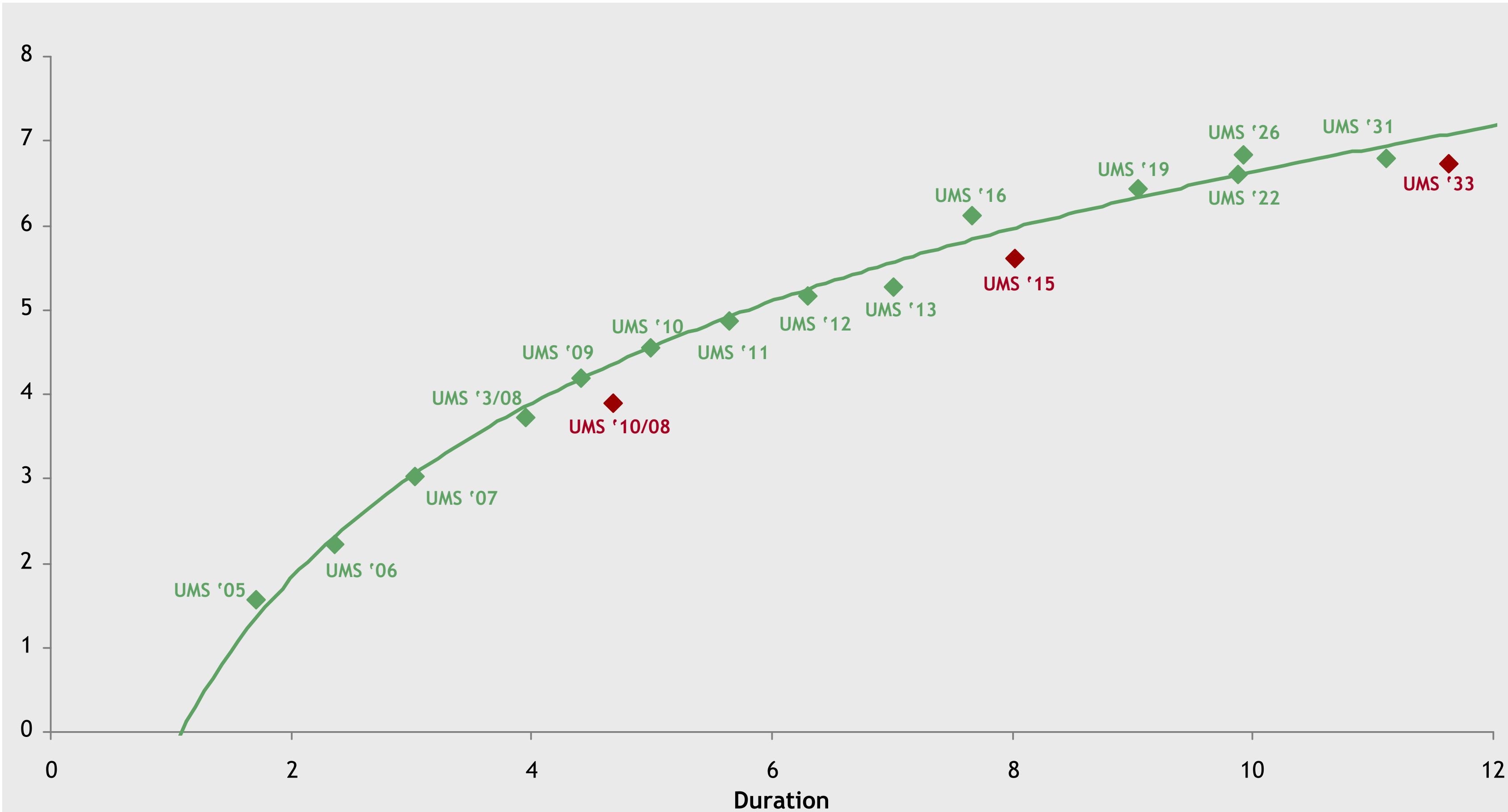
UMS Curve (Yield, %), As of pricing




Source: JPMorgan

# The UMS benchmark bonds with CACs trade in line or slightly through UMS's yield curve

**UMS Curve (Yield, %) - As of June 3, based on duration**

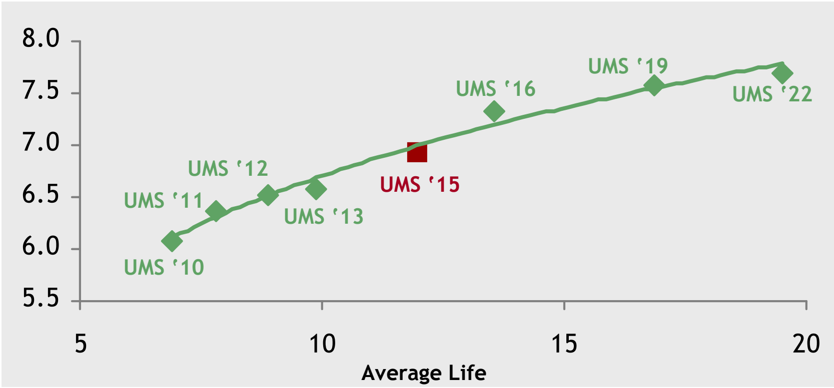



Source: JPMorgan

INVESTOR BASE AND PRICING

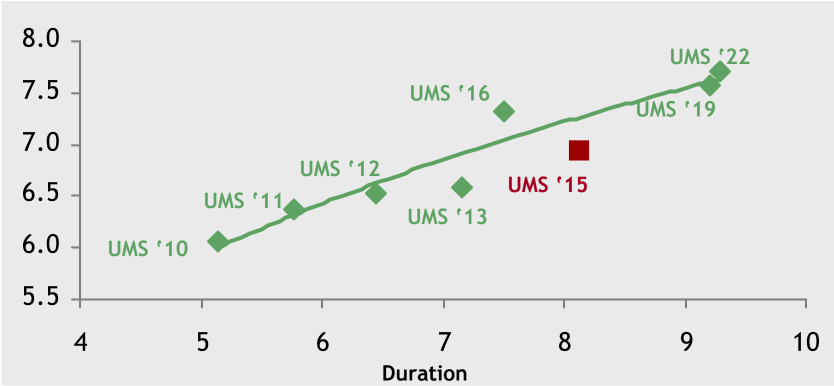
# The UMS 2015 pricing looks tight to the curve also when regressing only the bonds in that sector of the curve

UMS Curve based on average life (Yield, %), As of pricing



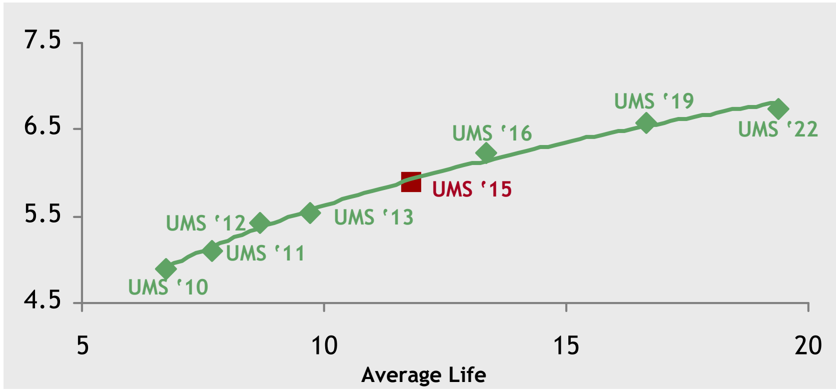

Source: JPMorgan

UMS Curve based on duration (Yield, %), As of pricing



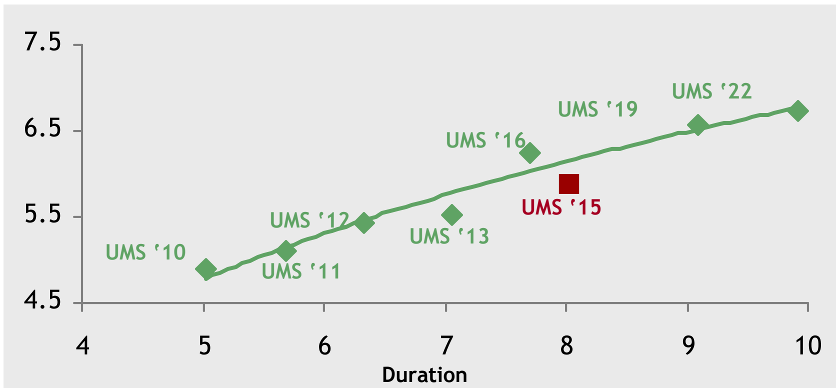

Source: JPMorgan

UMS Curve based on average life (Yield, %), As May 8




Source: JPMorgan

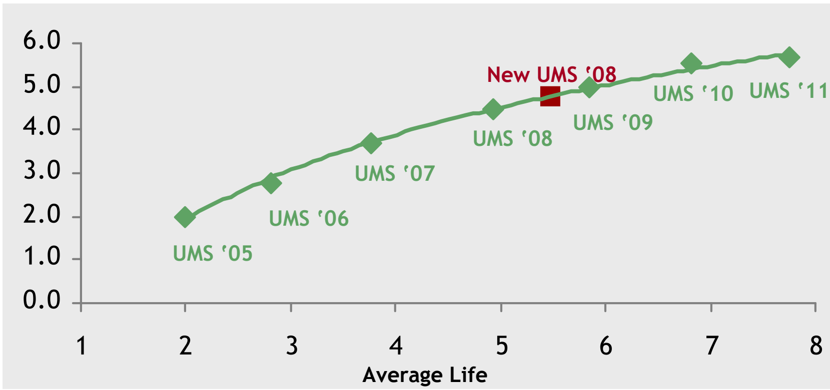
UMS Curve based on duration (Yield, %), As of May 8




Source: JPMorgan

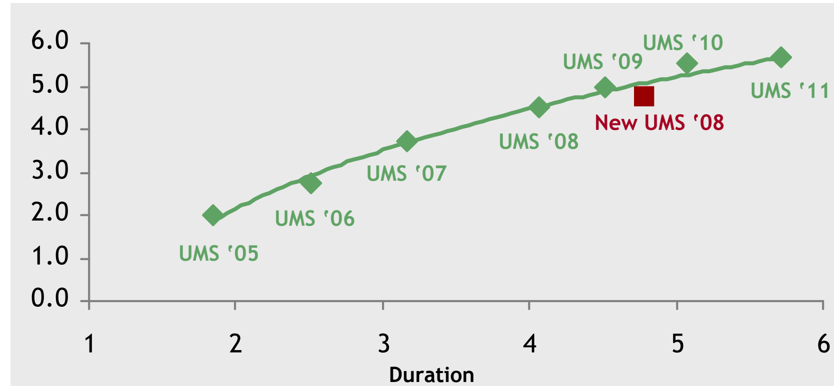
# Pricing of the UMS '08 was in line with the short/middle sector of the curve

**UMS Curve based on average life (Yield, %), As of pricing**



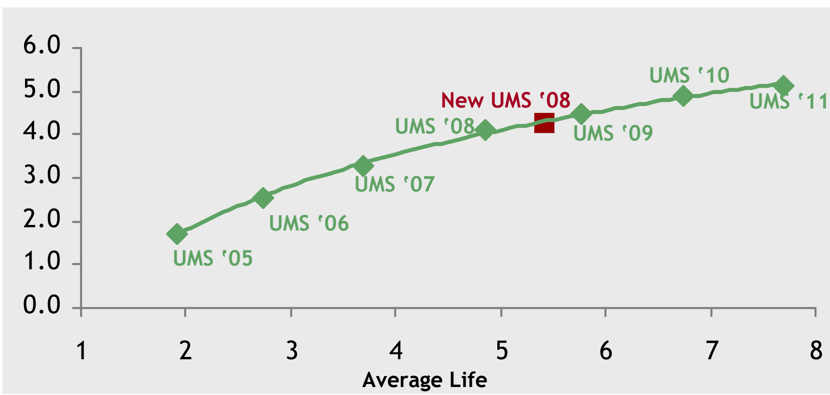

Source: JPMorgan

**UMS Curve based on duration (Yield, %), As of pricing**



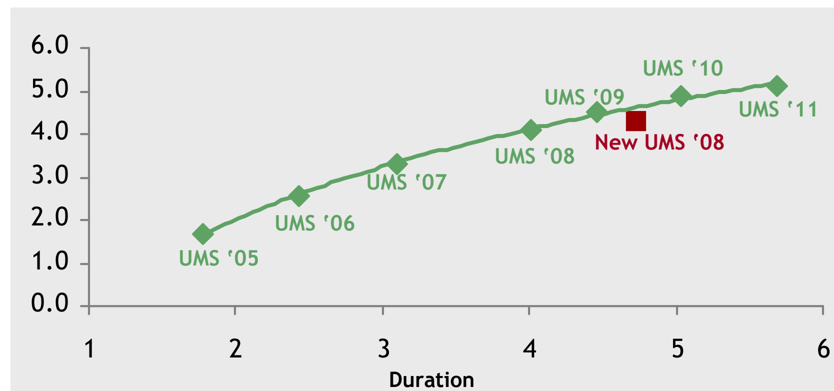

Source: JPMorgan

**UMS Curve based on average life (Yield, %), As May 8**




Source: JPMorgan

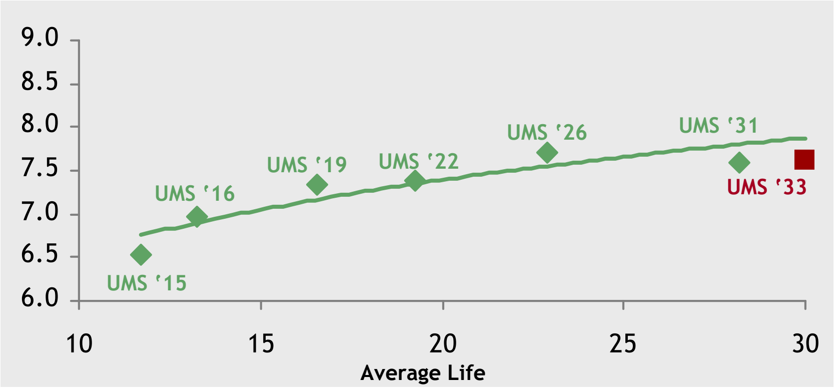
**UMS Curve based on duration (Yield, %), As of May 8**




Source: JPMorgan

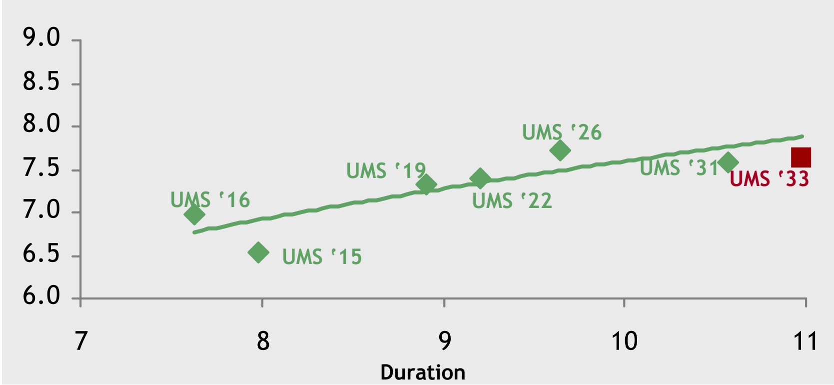
# Pricing of the UMS '33 was in line with the long sector of the curve

**UMS Curve based on average life (Yield, %), As of pricing**



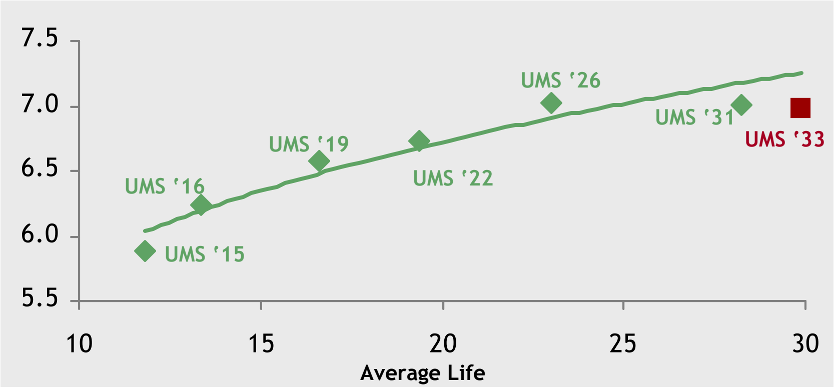

Source: JPMorgan

**UMS Curve based on duration (Yield, %), As of pricing**



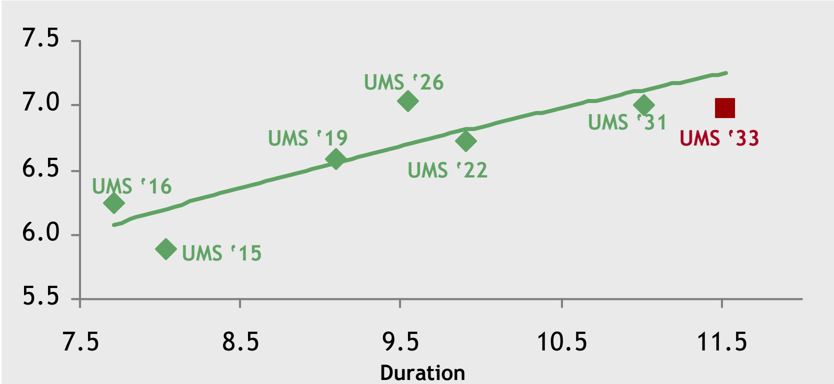

Source: JPMorgan

**UMS Curve based on average life (Yield, %), As May 8**




Source: JPMorgan

**UMS Curve based on duration (Yield, %), As of May 8**

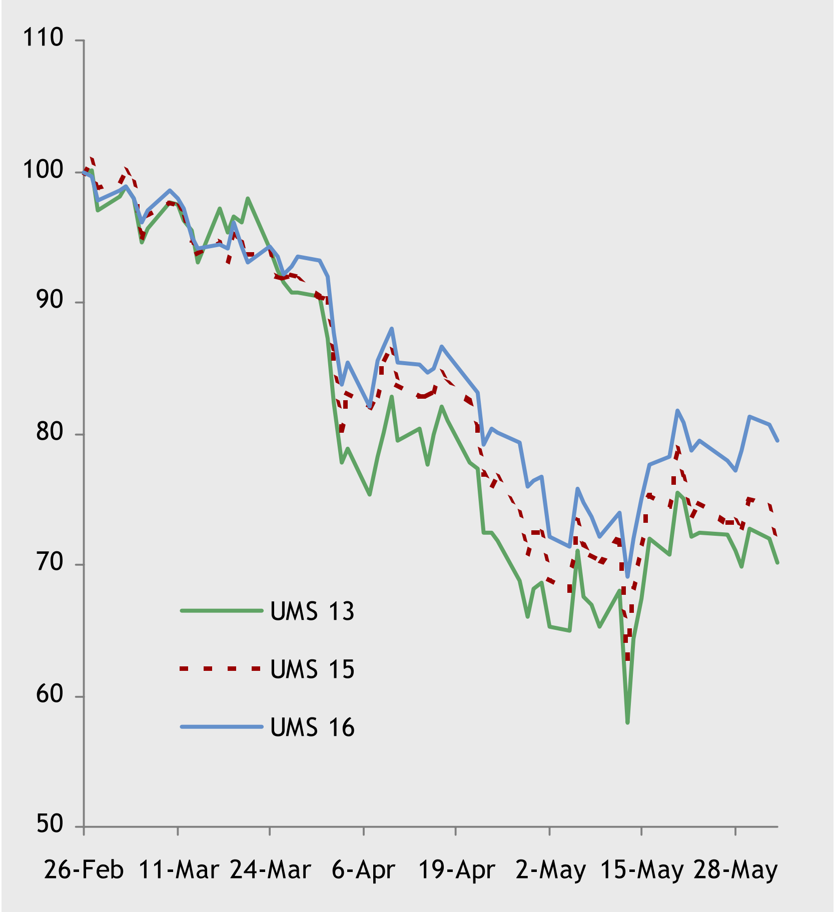



Source: JPMorgan

# Agenda

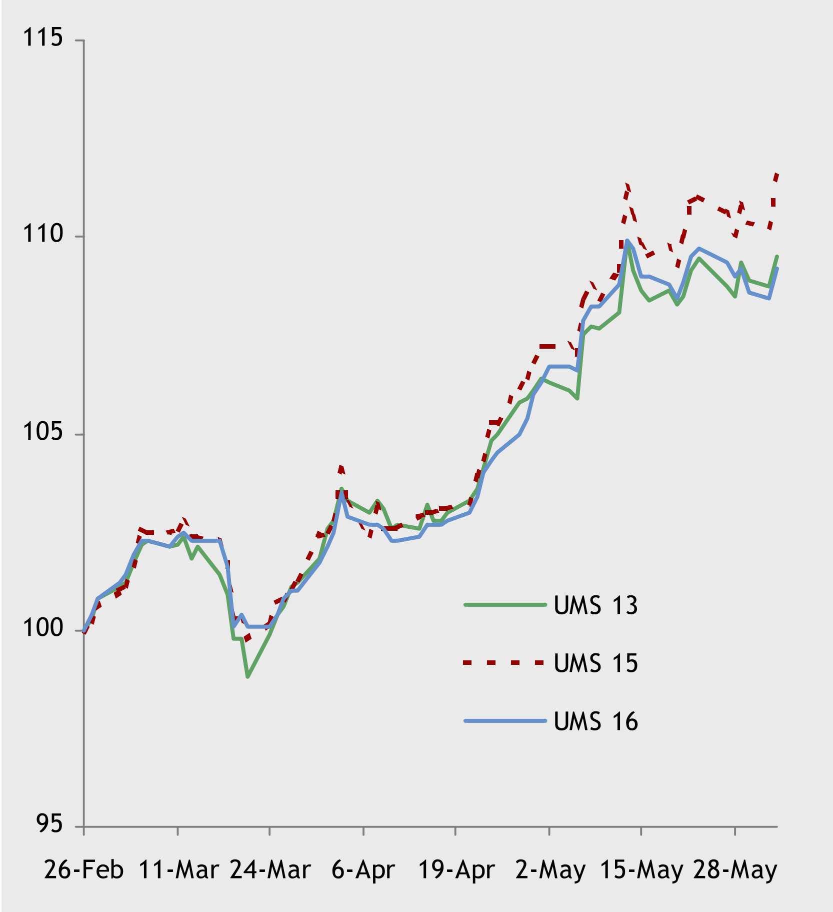
# Performance of the new UMS 15

**Spread Evolution - Feb 26 = 100**




Source: JPMorgan
Dotted lines denote bond with CACs

**Price Evolution, Feb 26 = 100**

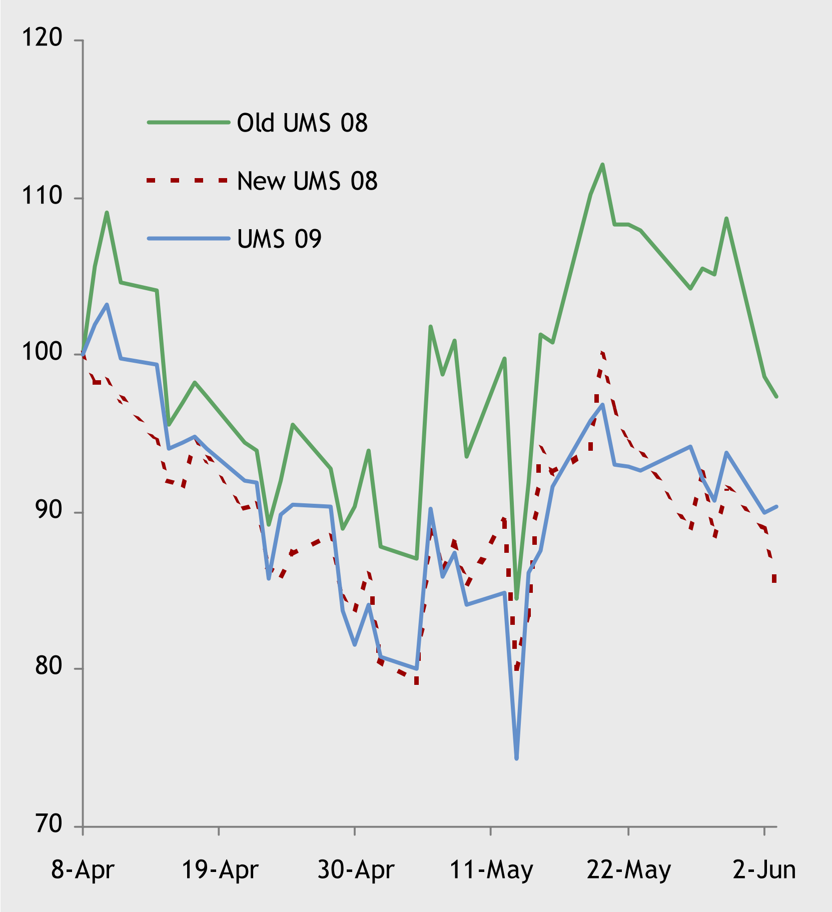



Source: JPMorgan
Dotted lines denote bonds with CACs

# Performance of the new UMS 08

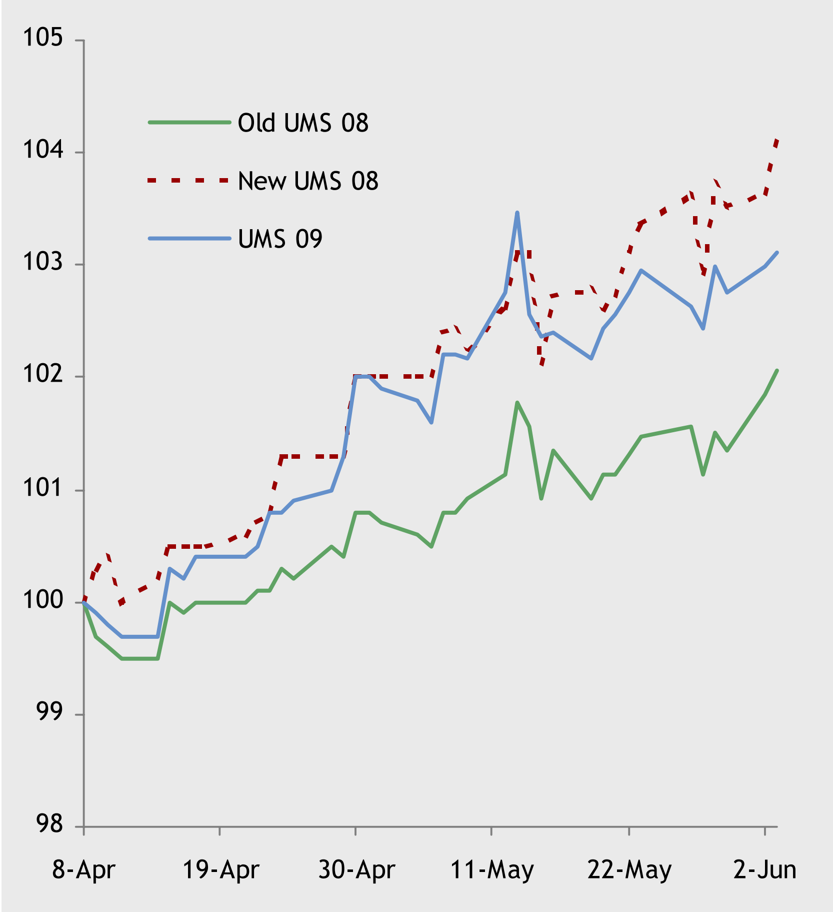


**Spread Evolution - Apr 8 = 100**




Source: JPMorgan
Dotted lines denote bond with CACs

**Price Evolution, Apr 8 = 100**




Source: JPMorgan
Dotted lines denote bonds with CACs

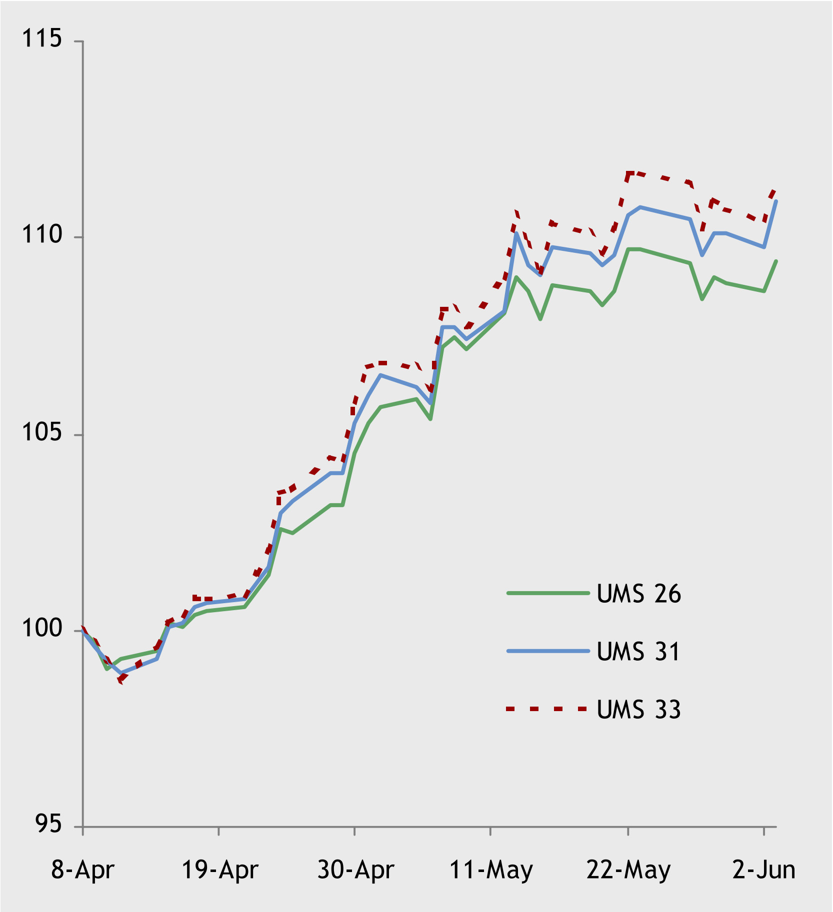
# Performance of the new UMS 33



**Spread Evolution - Apr 8 = 100**

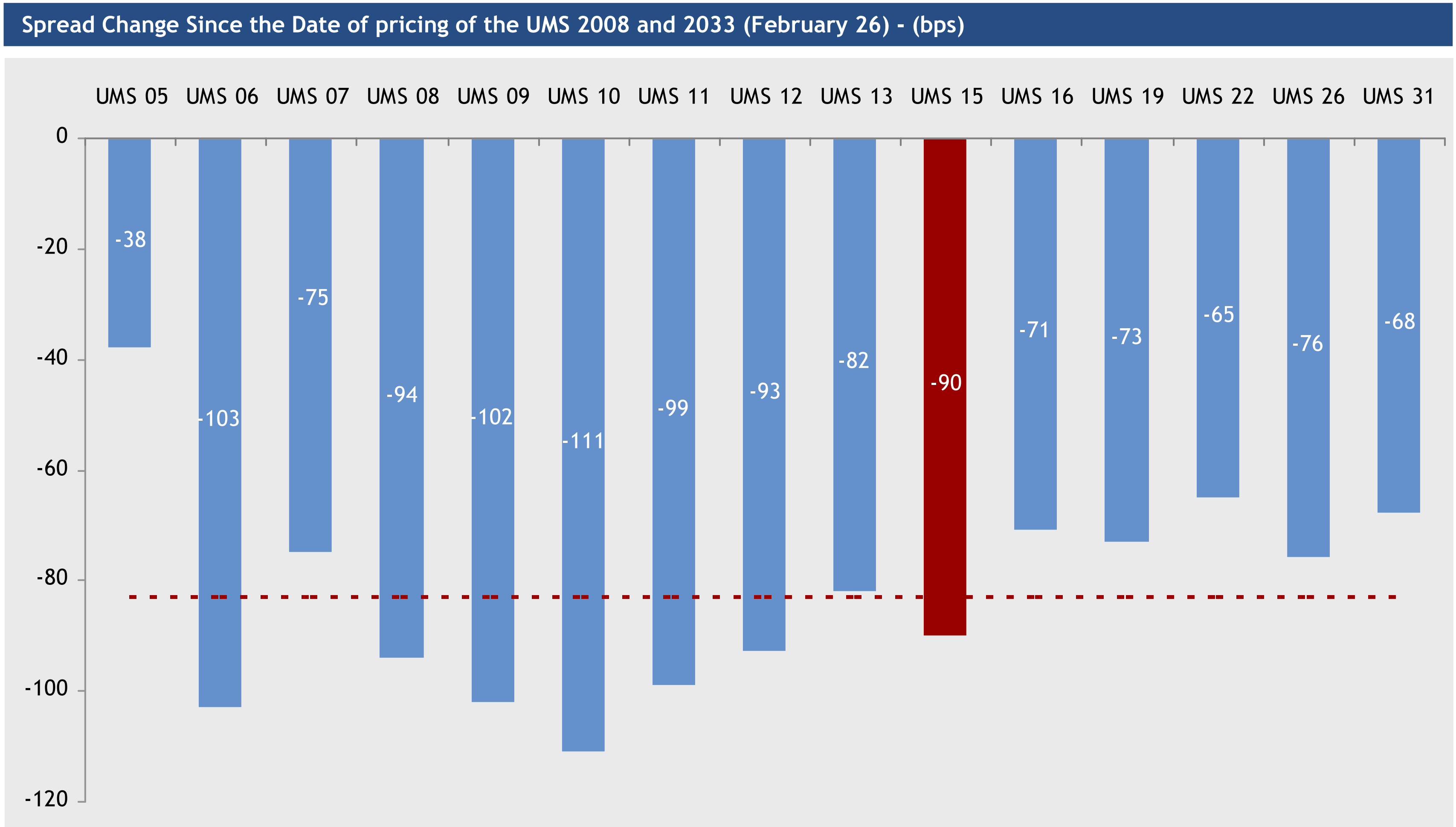

Source: JPMorgan
Dotted lines denote bond with CACs

**Price Evolution, Apr 8 = 100**




Source: JPMorgan
Dotted lines denote bonds with CACs

# On a relative basis, the UMS bonds with CACs have outperformed the other bonds since February 26

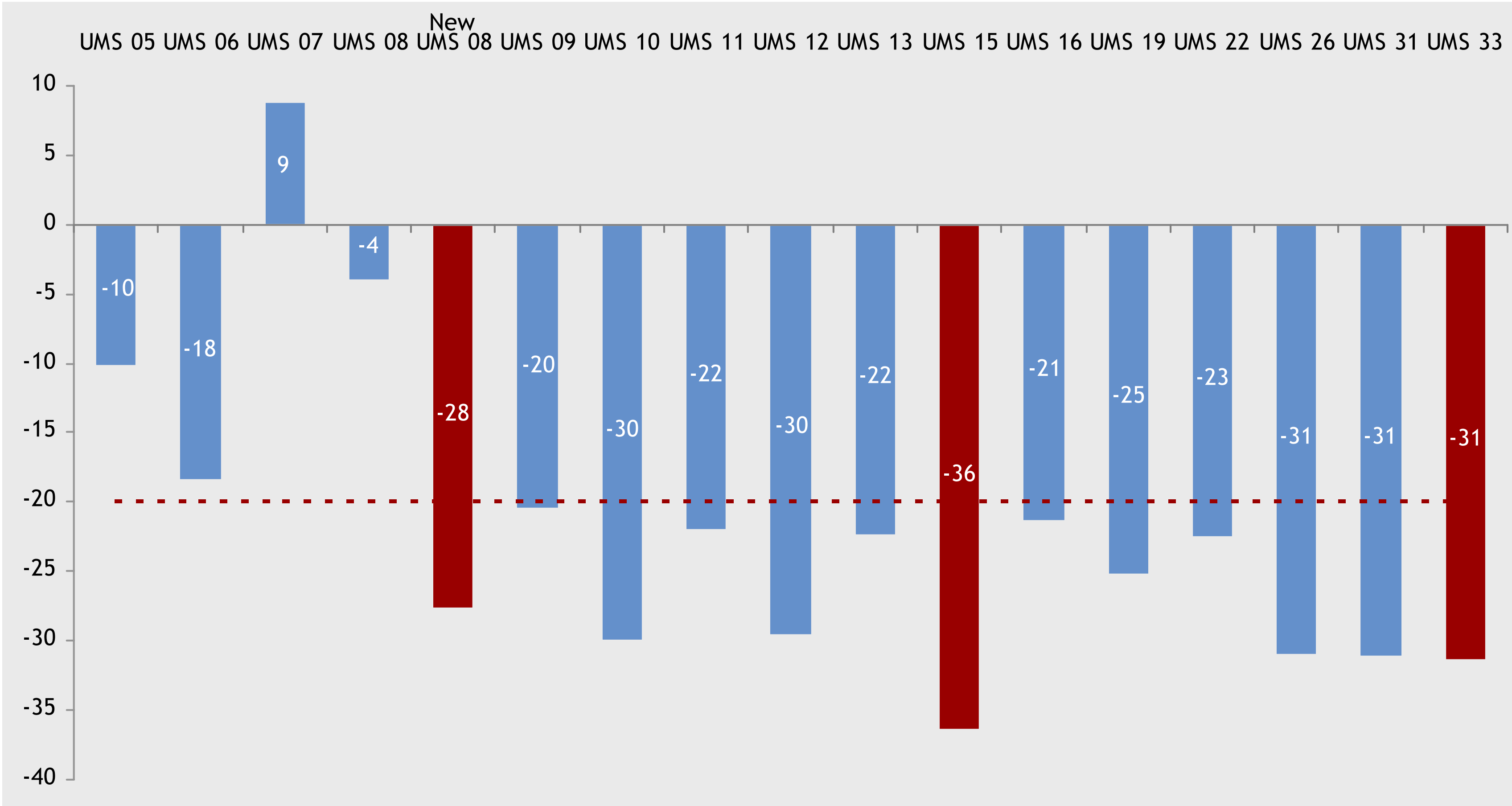



Source: JPMorgan
Dotted line denotes average spread change of UMS bonds without CACs
As of June 3, 2003

PERFORMANCE OF BONDS WITH CACS

# On a relative basis, the UMS bonds with CACs have outperformed the other bonds on the curve since April 8

Spread Change Since the Date of pricing of the UMS 2008 and 2033 (April 8) - (bps)




Source: JPMorgan

Dotted line denotes average spread change of UMS bonds without CACs

As of June 3, 2003

PERFORMANCE OF BONDS WITH CACS