EMTA's 15th Year - A Look Back to:

EMTA's Beginnings

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The Rohatyn Group

[EMTA was formally incorporated in December 1990. To help mark EMTA's 15th anniversary, EMTA's Bulletin is featuring a series reprinting articles on the early periods of EMTA's history. This issue contains Bruce Wolfson's nearly 'prehistoric' recollections of the informal meetings in the late 1980's that eventually led a group of leading Emerging Markets (then LDC!) debt traders to establish an industry trade association.

Bruce has been a leading EM lawyer and aficionado since the early 1980's, chaired EMTA's first Documentation Committee and has served as an EMTA Director since 1994. These recollections of EMTA's beginnings were first published in 2000, when Bruce was a Senior Managing Director at Bear Stearns.]

Not long after the first restructurings for Latin American debt were agreed in December 1982, the first loan trades were consummated. At first, the trades were for the limited purpose of allowing lenders to reallocate their portfolios of sovereign credits. Trades (called 'ratio' or 'cocktail' swaps) were structured as exchanges of assets, avoiding any mention of prices that might force the parties to adjust the value of billions of dollars of similar credits still on their books.

A few years later, provisions allowing creditors to exchange sovereign debt for equity or other assets were introduced into the new restructuring agreements. This brought added impetus to the trading markets, as prospective investors became purchasers of restructured debt. Financial institutions representing such investors often accumulated debt to be used in debt/equity and other swaps.

The restructuring process continued in Latin America throughout the 1980's and then spread to other Emerging Markets around the world. The first round of restructuring was succeeded by others, vastly increasing the supply of tradable loans. When Citibank established a significant reserve against its LDC debt in the spring of 1987, most other major lenders followed. Sales for cash by some lenders to generate tax losses occurred in late 1987, and throughout 1988 the cash market further developed. Loan trading volumes soared, heralding the creation of a new trading asset class and bringing considerable attention to this young industry.

Unfortunately, not all of the attention was favorable. Press coverage of the trading industry (as well as coverage of bank debt negotiations) was somewhat hostile, and market rumors abounded. Banking regulators had begun to express their concerns that sovereign loan trading resembled a 'Wild West Show'.

As book values of loans became more realistic, it became harder to get commercial banks to make the new money loans required under the Baker Plan. At the same time, public concerns were growing about the ability of sovereign borrowers to repay loans, and about the cost to the countries of doing so. Mexico's Aztec Bonds in 1988 represented one of the early efforts by a debtor country to 'capture the discount' that the trading markets had made plain to all.

Against this backdrop, U.S. Treasury Secretary Nicholas Brady delivered an address at Bretton Woods in March 1989 proposing partial forgiveness of LDC debt in exchange for collateralized instruments that would be easier to trade. Mexico's negotiations began the next month, resulting in a deal by July and a term sheet in September. The deal was set to close in March 1990.

There were many significant aspects of the so-called "Brady Plan". Principal maturities were to be extended to thirty years. Debt relief was provided by means of a reduction in principal (in the case of Mexico, by 35%) or interest (in Mexico's case, to 6.25% fixed). The U.S. Treasury sold borrowers zero-coupon bonds to be used as principal collateral. Interest was to be partially collateralized as well. Oil warrants, called Value Recovery Rights, were issued to Mexico's creditors, and Venezuela, Uruguay, Nigeria and Costa Rica issued similar instruments. Perhaps most importantly for purposes of this article, loans were to be exchanged for bonds in a variety of series and currencies, all of which were designed to be instruments capable of trading freely in the secondary markets.

From the term sheet, Brady Bonds looked like they would be complicated trading instruments, and the trading community pondered the approaching deadline for their creation. For years, Emerging Markets trading desks had devoted enormous amounts of time and money to preparing, negotiating and executing loan trading documentation on a trade-by-trade basis. Although a small group of commercial banks had worked out confirmation forms for the Aztec Bonds, there were no other standard documents or market practices, and loan trades routinely took weeks to settle. Most of the major players were commercial banks or former commercial bankers with just enough experience in bond trading to know that individually negotiated documentation and delayed settlements would not work for Brady Bonds.

A few traders had long harbored hopes of creating a trade association to bring greater efficiency and transparency to the markets. The advent of the Brady Plan, along with the added regulatory focus on the growing loan trading business, made the moment ripe. One afternoon in late 1989, Peter Geraghty, then head of the LDC debt trading business at NMB, invited a few of his colleagues around the Street to discuss procedures for trading Brady Bonds.

The urgent need to develop standard documents for trading Brady Bonds was recognized by all, but most firms were hesitant to confer any authority to enforce their use or define market practices. As the meeting adjourned, a small group of lawyers was formed to prepare draft confirmations, but no decision to form a trade association was taken.

In the weeks and months that followed, Peter Geraghty continued to lobby his colleagues to form a trade association to bring greater order and efficiency to the markets. Nick Rohatyn of JP Morgan argued that industry standards had to be above reproach and that such an association could address concerns of regulators that LDC loan trading was in need of increased regulation. As the effort to create standard bond confirmations proceeded, the firms seemed to grow more comfortable with the idea of working together under the auspices of a trade association. In due course, trade confirmation forms for Mexico's Brady Bonds were completed and put into use.

The first issuance of Brady Bonds [March 1990] gave further fuel to the market's growth and development. Before long, the first broker's screens were introduced. If LDC debt trading was still a club, its membership was growing.

As interest in a trade association grew, many of the fears remained. There was widespread agreement on the wisdom of developing standard documentation that counterparties could use to facilitate settlement. There was also significant support for publishing standard market practices that would govern all trades unless the parties otherwise agreed. On the other hand, there was no appetite for a self-regulatory organization. Participation in the new trade group, provisionally called the LDC Debt Traders Association, was to be wholly voluntary. There was to be no authority to require members to use standard documents or to follow published market practices. The Association was to act only on matters as to which a broad consensus could be reached.

Thus, the decision was made to form the association that is today the Emerging Markets Traders Association. The eleven original Directors, which included a number of the traders who had attended the early Aztec and Brady Bond meetings, were Rick Haller of Morgan Grenfell, Kathy Galbraith of The Chase Manhattan Bank, Nick Rohatyn of JP Morgan, Peter Geraghty of NMB, Alex Rodzianko of Manufacturers Hanover, Peter Drittel of Bear, Stearns, Manuel Mejia-Aoun of Merrill Lynch, Steve Dizard of Salomon Brothers, Hugo Verdegaal of Citibank, Neil Allen of Bankers Trust, and Robert Trisciuzzi of Bank of Tokyo. Nick Rohatyn served as the first Chair and later contributed EMTA's first offices and Executive Director — Tom Winslade, a JP Morgan attorney, who was seconded to EMTA full-time from June 1992 through 1993. Following a 'beauty contest', Michael Chamberlin of Shearman & Sterling was named outside legal counsel in late 1990 and was charged with incorporating the Association.

In December 1990, the LDC Debt Traders Association was formally incorporated. What began the 1980's as a few heavily negotiated asset swaps greeted the 1990's as a major industry. The subsequent years have been challenging for EMTA, and for the business it represents. But through the many highs and lows, there can be little doubt that the efforts of those who met in that conference room at NMB just over a decade ago have contributed more to the stability and transparency of the Emerging Markets than even they could have imagined.